CAKE-AND-EAT-IT-TOO CLAUSES

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Imagine this: You have signed on the dotted line to purchase a home for $500,000. You have put down an earnest money deposit of $25,000. Right before closing, you find out that your bank will not provide the financing you thought you had secured. You can no longer afford to purchase your dream home. You are coming to grips with the reality that you are going to lose $25,000, which comprises the bulk of your life savings. Then you hear from the seller, telling you that they are going to come after you for $100,000 in "actual damages"—the amount the house depreciated between the time you signed the purchase and sale agreement and the time you breached the contract. How is this possible? It is bad enough that you are going to lose $25,000. How can you be on the hook for even more? It is because of a little-known clause in your purchase and sale agreement that provides the seller with the option of retaining the deposit as liquidated damages or suing for actual damages instead. These clauses have a variety of names: election clauses, election of remedies clauses, optional liquidated damages clauses, or cake-and-eat-it-too clauses.

A surprising number of courts are prepared to give effect to these clauses, reasoning that they represent the parties' intent, and that freedom of contract demands that they be enforced. This Article argues that courts are getting it wrong: liquidated damages clauses cannot be reconciled with election clauses. No amount of freedom of contract logic can get around the fact that the two clauses are legally incompatible.

This Article examines the two different contexts in which liquidated damages clauses and election clauses intersect. First, a buyer may seek a return of his earnest money deposit, arguing that the presence of an election clause renders the liquidated damages a penalty. Second, a buyer may seek to foreclose a seller from pursuing actual damages under an election clause, reasoning that such a clause is fundamentally at odds with a liquidated damages clause. In the first scenario, the buyer seeks to invalidate the liquidated damages clause; in the second, he seeks to invalidate the election clause. This Article encourages courts to prohibit liquidated damages clauses and election clauses from coexisting in contracts. A seller who attempts to have his cake and eat it too should be relegated to the lesser of the two amounts.

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* Professor of Law, University at Buffalo School of Law. This Article was inspired by a dinner conversation with my father. He informed me that sellers in Toronto, Canada, were going after buyers who reneged on their purchase and sale agreements for their actual losses *in addition to* keeping their earnest money deposit. I responded, "But that's impossible. You can't do both. If you put down an earnest money deposit, that's the extent of your liability." I thought he was totally off base. Lo and behold, he was right. Canadian law permits a seller to retain an earnest money deposit and sue for actual damages. And so, this Article was born.

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INTRODUCTION

> [*A*] *principal issue raised by liquidated damages clauses is whether they preclude the vendor's assertion of other remedies, especially actual damages and specific performance. . . . Surprisingly, numerous cases permit the seller to disregard the liquidated damages clause and seek actual damages . . . .*[1]

It was October 2021, the peak of the COVID-19 real estate frenzy.[2] First-time homebuyer Gurcharan Rehal signed a contract to purchase a new-build construction home for close to $2.1 million.[3] Rehal, an Uber driver and property manager, knew that the price was high but reasoned that if his family lived "hand-to-mouth" they could afford it.[4] Rehal planned to live in the home with his wife, two children, and mother.[5]

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1. DALE A. WHITMAN, ANN M. BURKHART, R. WILSON FREYERMUTH & TROY A. RULE, THE LAW OF PROPERTY 628 (4th ed. 2019).

2. *See* Sai Balasubramanian, *The COVID-19 Pandemic Has Fueled a Crisis in the Housing Market*, FORBES (Apr. 27, 2021, 1:48 PM), https://www.forbes.com/sites/saibala/2021/04/27/the-covid-19-pandemic-has-fueled-a-crisis-in-the-housing-market/?sh=7220819f5928 [https://perma.cc/28GV-E6LR]; Hanna Ziady, *People Are Panic Buying Homes as Prices Skyrocket Around the World*, CNN, https://www.cnn.com/2021/05/13/business/global-real-estate-prices/index.html [https://perma.cc/25Z6-K2L8] (May 13, 2021, 5:14 AM); Ryan Patrick Jones, *They Purchased Homes Right Before the Real Estate Downturn. Now, They're Struggling To Close*, CBC, https://www.cbc.ca/news/canada/toronto/ontario-homebuyers-struggle-close-1.6685427 (Dec. 20, 2022).

3. Jones, *supra* note 2. The purchase price of the house was $1.959 million, but Rehal opted for $90,000 in upgrades. *Id.*

4. *Id.*

5. *Id.*

What he did not anticipate was that the value of the property would plummet to $1.7 million just over a year later, when it was time to close on the transaction.[6] With rapidly rising interest rates, Rehal's mortgage payments would go from $5,500–$6,000 per month (what he was pre-approved for) to between $12,000 and $15,000 per month.[7] Rehal has not been able to secure a mortgage and is unsure whether he will be able to afford the purchase.[8] He states, "Me and my wife, I think we haven't slept for [the] last three months, ... Our kids, they can see the stress on [our] face[s]."[9] Rehal risks losing his $260,000 earnest money deposit if he fails to close on the transaction.[10] That would be bad enough. But, due to an oft-overlooked clause in the purchase and sale agreement, Rehal might also be on the hook for actual damages, an amount that probably exceeds $300,000.[11]

Many standard real estate contracts contain clauses that permit the seller either to retain an earnest money deposit in full satisfaction of the damages owed or to sue for actual damages instead. These clauses go by

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6. *Id.* It is unclear whether the upgrades were factored into the appraisal.

7. *Id.* The problem of rising interest rates is particularly acute with yet-to-be-built construction. *See* Nicole Friedman, *They Signed Contracts for Their Dream Homes Last Year. Now Their Borrowing Costs Are Ballooning*, WALL ST. J. (May 15, 2022, 5:30 AM), https://www.wsj.com/articles/they-signed-contracts-for-their-dream-homes-last-year-now-their-borrowing-costs-are-ballooning-11652607001; Chris Arnold, *The Pain of Rising Mortgage Rates When You're Waiting for Your Home To Be Built*, NPR (June 29, 2022, 7:01 AM), https://www.npr.org/2022/06/29/1107292871/the-pain-of-rising-mortgage-rates-when-youre-waiting-for-your-home-to-be-built [https://perma.cc/LZ89-LT42]. In Toronto, Canada, some buyers of new construction housing are walking away from deposits of up to $320,000 and may be liable for actual damages on top of that. *See* Clarrie Feinstein, *Toronto-Area Buyers Are Walking Away from Deposits on New Homes — Some Losing as Much as $300,000*, TORONTO STAR, https://www.thestar.com/real-estate/toronto-area-buyers-are-walking-away-from-deposits-on-new-homes-some-losing-as-much/article_db451c58-5c4b-5269-8510-17095d5496e1.html (Nov. 3, 2023).

8. Jones, *supra* note 3.

9. *Id.* (first alteration in original).

10. *Id.*

11. Rehal signed an agreement to purchase a new-build home in Brampton, Ontario, a suburb outside of Toronto. *Id.* Canadian courts have been very clear that aggrieved sellers are not limited to the earnest money deposit and have the right to pursue actual damages. In recent years, there have been several shocking awards against homebuyers who backed out of their purchase and sale agreements in Canada. *See Gamoff v. Hu*, 2018 ONSC 2172 (ordering buyers to pay $470,000 in damages; $30,000 deposit already paid to the sellers presumably deducted from total amount); *Albrechtsen v. Panaich*, 2017 BCSC 1361 (ordering buyers to pay approximately $300,000 in damages in addition to the $60,000 deposit); *Deco Homes (Richmond Hill) Inc. v. Serikov*, 2021 ONSC 2079 (ordering approximately $154,000 in damages in addition to $120,000 in deposits already paid).

a variety of names: election clauses,[12] election of remedies clauses,[13] optional liquidated damages clauses,[14] and cake-and-eat-it-too clauses.[15] The latter is probably the most apt description because it lays bare what these clauses purport to do: allow a seller a no-downside risk scenario where he is guaranteed a minimum recovery in the amount of the earnest money deposit *plus* the option to recover more if the liquidated amount does not make him whole.[16] These clauses, in effect, allow the seller to have his cake (a minimum guarantee of damages) and to eat it too (to sue for more if damages exceed the liquidated amount).[17]

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12. *E.g.*, *Rocky Mountain Hosp., LLC v. Mountain Classic Real Est., Inc.*, 523 P.3d 187, 192 (Utah 2022).

13. *E.g.*, *Mountain Courtyard Suites v. Wysong*, 452 F. Supp. 3d 1275, 1283 (D. Utah 2020).

14. *E.g.*, *Grossinger Motorcorp, Inc. v. Am. Nat'l Bank & Tr. Co.*, 607 N.E.2d 1337, 1346 (Ill. App. Ct. 1992); *M.L.G. Tr. v. Gov't of the Republic of Indon.*, No. 89 C 6649, 1994 WL 549078, at *2 (N.D. Ill. Oct. 3, 1994); *Res. Tech. Corp. v. Cong. Dev. Co.*, No. 03 C 2254, 2003 WL 22057489, at *2 (N.D. Ill. Sept. 4, 2003).

15. Technically, most courts use the moniker "Have Cake and Eat It" clauses. *See, e.g.*, *Lefemine v. Baron*, 573 So. 2d 326, 330 (Fla. 1991) (quoting JOHN D. CALAMARI & JOSEPH M. PERILLO, THE LAW OF CONTRACTS 644 (3d ed. 1987)); *Merrillville Conservancy Dist. ex rel. Bd. of Dirs. v. Atlas Excavating, Inc.*, 764 N.E.2d 718, 724 (Ind. Ct. App. 2002); *Tenn. Homes v. Welch*, 664 S.W.3d 1, 16 (Tenn. Ct. App. 2022). However, courts often also use the expression "cake-and-eat-it-too" in their analyses of such clauses. *See, e.g.*, *Grossinger Motorcorp*, 607 N.E.2d at 1347 ("This is no settlement at all and it permits the [seller] to have his cake and eat it too." (quoting *Dalston Constr. Co. v. Wallace*, 214 N.Y.S.2d 191, 193 (Dist. Ct. 1960))); *Stock Shop, Inc. v. Bozell & Jacobs, Inc.*, 481 N.Y.S.2d 269, 271 (Sup. Ct. 1984). *See also* Plaintiff Petitioners' Reply to Opposition to Petition for Writ of Certiorari at 1, *Ravenstar, LLC v. One Ski Hill Place, LLC*, 401 P.3d 552 (Colo. 2017) (No. 16 SC 224), 2016 WL 9227404 (referring to the clause as a "cake-and-eat-it-too clause"). Most people are more familiar with the expression "cake-and-eat-it-too" rather than "have cake and eat it." *See, e.g.*, Jeffrey Ruebel, *Liquidated Damages*, RUEBEL & QUILLEN, LLC (Feb. 1, 2016), https://www.rq-law.com/news/liquidated-damages/ [https://perma.cc/Y7Q5-36CX] (observing that "the [*Ravenstar* court] discussed the meaning of 'having one's cake and eating it too' within the context of a contract clause which gave the non-defaulting party the option of being entitled to liquidated damages or alternatively recovering actual damages"); Paul Brians, *You Can't Have Your Cake and Eat It Too*, WASH. ST. U.: THE WEBSITE OF PROF. PAUL BRIANS, https://brians.wsu.edu/2016/05/19/you-cant-have-your-cake-and-eat-it-too [https://perma.cc/4G5S-2KAP] ("The most popular form of this saying [is] 'You can't have your cake and eat it too . . . .'").

16. *See Grossinger Motorcorp*, 607 N.E.2d at 1347 ("[S]uch an optional liquidated damages provision fixes a minimum which must be paid from the buyer to the seller, 'but leaves the door wide open to him to prove actual damage in addition to the so called liquidated damage. This is no settlement at all and it permits the [seller] to have his cake and eat it too.'" (quoting *Dalston Constr.*, 214 N.Y.S.2d at 193))).

17. *See Zuckerman v. Vanu, Inc.*, No. MICV2010-00967, 2013 WL 1799859, at *8 (Mass. Super. Ct. Jan. 28, 2013) ("Boston Properties negotiated a heads-I-win, tails-you-lose proposition. If it turned out after the fact that actual damages were negligible or at least relatively small, then it could choose to collect substantial liquidated

Even though "cake-and-eat-it-too" clause is the catchiest of the various monikers, this Article generally employs the term "election" clause instead. First, while the term "cake-and-eat-it-too" clause is vivid and memorable, it is also a mouthful (pun intended). Second, a previous article of mine discussing earnest money deposits in real estate transactions referred to such clauses as "election" clauses.[18] For the sake of internal consistency, that term will be used in this Article as well. Nonetheless, the more descriptive phraseology—cake-and-eat-it-too clauses—has been retained as the title of this Article as it is perfect shorthand for what should concern courts about these clauses.

This Article proceeds as follows. Part I discusses election clauses and how they are likely to appear in real estate contracts. It also offers some thoughts on why this issue is particularly salient in the post-COVID-19 real estate era. Part II outlines the two contexts in which courts are asked to consider the interplay between liquidated damages clauses and election clauses. The first scenario is where a seller would like to retain the earnest money as liquidated damages and the buyer argues that the presence of an election clause renders the liquidated damages clause a penalty. The second scenario is where the seller would like to elect actual damages and the buyer argues that the seller's recovery should be capped at the liquidated amount. Parts III and IV examine and debunk the courts' logic in these two separate contexts, arguing that liquidated damages clauses are fundamentally incompatible with election clauses. Part V examines whether an election clause preserving the seller's right to seek specific performance is any different than an election clause which grants the seller the right to seek monetary remedies. Part VI situates the election clause discussion into a larger conversation about the lopsidedness inherent in real estate contracting, where the seller decidedly retains the upper hand. Part VII proceeds to examine what may be motivating courts with respect to the election clause issue. The penultimate section, Part VIII, offers guidance on what courts should do when presented with a case involving an election clause. This Article then provides some concluding remarks.

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damages. But if it turned out that actual damages were much higher, then Boston Properties could eschew the liquidated damage amount and instead press for higher actual damages."); *Jarro Bldg. Indus. Corp. v. Schwartz*, 281 N.Y.S.2d 420, 426 (App. Term 1967) ("It operates to give appellant a minimum recovery regardless of actual damages and also affords him the option to disregard the liquidated damages specified if the actual damages exceed the amount stipulated.").

18. Tanya J. Monestier, *Fixer Upper: Buyer Deposits in Residential Real Estate Transactions*, 80 OHIO ST. L.J. 1149, 1222 (2019).

I. ELECTION CLAUSES IN REAL ESTATE CONTRACTS

An election clause is what it sounds like: a contractual provision that permits a party to elect its remedy after the fact.[19] Election clauses can appear in any type of contract[20] but are particularly ubiquitous in real estate purchase and sale agreements.[21] In most real estate transactions, the buyer puts down a sum of money known as an earnest money deposit.[22] In the event the contract is breached, the buyer typically forfeits this earnest money as liquidated damages.[23] Courts have treated earnest money deposits in real estate transactions as a form of liquidated damages, whether or not the contract explicitly designates them as such.[24]

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19. For an example of an election clause, see *Luxe Homes, LLC v. Brewer*, 359 So. 3d 626, 629 (Miss. 2023) ("In the event of breach of this contract by Buyer, Seller at his option may either: (1) accept the earnest money deposit as liquidated damages and this contract shall then be null and void, or (2) enter suit in *Rankin County, Mississippi* for damages, giving credit on said damages for the said earnest money deposit, or (3) enter suit in *Rankin County, Mississippi* for specific performance . . . .").

20. *See, e.g.*, *Brands Within Reach, LLC v. Belvoir Fruit Farms Ltd.*, No. 19-cv-4947, 2022 WL 4585445, at *8–9 (S.D.N.Y. Sept. 29, 2022) (beverage distribution agreement); *Republic Bank of Chi. v. Desmond*, No. 13 C 6835, 2014 WL 3905712, at *2 (N.D. Ill. Aug. 11, 2014) (lease agreement); *Zuckerman*, 2013 WL 1799859, at *9 (lease agreement); *AAR Int'l, Inc. v. Vacances Heliades S.A.*, 349 F. Supp. 2d 1114, 1116 (N.D. Ill. 2004) (airplane lease agreement); *Franklin First Fin., Ltd. v. Contour Mortg. Corp.*, No. 604159-15, 2019 WL 886000, at *3 (N.Y. Sup. Ct. Feb. 19, 2019) (confidentiality agreement in an employment contract); *Comprehensive Mfg. Assocs. v. SupplyCore, Inc.*, No. 15-CV-835, 2016 WL 4444883, at *1, *5 (N.D.N.Y. Aug. 23, 2016) (supply agreement).

21. *Mountain Courtyard Suites v. Wysong*, 452 F. Supp. 3d 1275, 1280–81 (D. Utah 2020) ("Provisions comparable (indeed, sometimes virtually identical) to [the election clause in] Section 16 appear to be common in agreements to purchase real estate in Utah . . . .").

22. 24 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 65:24 (4th ed. 2002) ("Instead of providing for the payment of a liquidated sum in respect of a breach, contracts for sale and purchase of property frequently require an actual payment to be made in connection with the execution of the contract, in order to secure the purchaser's performance, usually called either a 'deposit' or 'earnest money.' . . . [I]ts governing principles are substantially the same as those generally applied in the case of stipulated damages provisions . . . .") [hereinafter WILLISTON ON CONTRACTS].

23. A liquidated damages clause in a contract specifies in advance the amount a party owes in the event of a breach. Seana Valentine Shiffrin, *Remedial Clauses: The Overprivatization of Private Law*, 67 HASTINGS L.J. 407, 413 (2016) ("A remedial clause, or what is usually termed a 'stipulated damages' or 'liquidated damages' clause, is a contractual term that specifies what duties, usually the payment of damages, will be owed by one contracting party to another should the former breach the performance terms of the contract. In essence, they are terms that prospectively specify particular remedies for the contingency that a legal duty is later abrogated.").

24. *Berggren v. Hill*, 928 N.E.2d 1225, 1229 (Ill. App. Ct. 2010) ("In the absence of an express provision to the contrary, a provision for the forfeiture of earnest

This is because an earnest money deposit is thought to represent the parties' agreement on the amount that will be owed if a buyer breaches the contract. If this is the seller's sole monetary remedy, then the only issue for a court to consider is whether the earnest money deposit constitutes a penalty and is therefore unenforceable.[25] Things become more complex, however, when a liquidated damages provision is coupled with an option that allows a seller to select from several post-breach remedies, including monetary damages and specific performance.

Some election clauses expressly state that the seller has the option of retaining the earnest money deposit or suing for actual damages instead. For example, a purchase and sale agreement in a recent case provided as follows:

> If Purchaser defaults in the performance of any obligation under this Agreement . . . Seller shall have the right to terminate this Agreement and shall be entitled to retain all or a portion of the Earnest Money and Construction Deposit . . . as liquidated damages . . . . Alternatively and in lieu of Seller's Liquidated Damages, Seller may elect to terminate this Agreement and recover its actual damages . . . .[26]

Most purchase and sale agreements, however, do not specifically mention the seller's right to obtain "actual damages."[27] Instead, they allude generically to the seller's right to pursue other remedies or relief

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money will be construed as a liquidated damages clause."). The deposit in a real estate transaction is rarely settled on with a view to pre-estimate damages, and often ends up looking like a penalty. Nonetheless, courts tend to enforce them with little meaningful scrutiny. *See* Monestier, *supra* note 18, at 1170–77.

25. *See* Monestier, *supra* note 18, at 1155–56.

26. *Ravenstar, LLC v. One Ski Hill Place, LLC*, 401 P.3d 552, 553 (Colo. 2017) (emphasis omitted). *See also EagleBank v. Schwartz*, No. 22-cv-01762, 2023 WL 6901964, at *10 (D. Colo. Aug. 18), *report and recommendation adopted*, No. 22-cv-01762, 2023 WL 6064596 (D. Colo. Sept. 18, 2023) ("Seller may elect to cancel this Contract and all Earnest Money (whether or not paid by Buyer) will be paid to Seller and retained by Seller. . . . Seller may recover such additional damages as may be proper. Alternatively, Seller may elect to treat this Contract as being in full force and effect and Seller has the right to specific performance or damages, or both.").

27. Stevens A. Carey, *Liquidated Damages in a Real Estate PSA: A Closer Look*, PRAC. REAL EST. LAW., Jan. 2019, at 24, 27 ("While the contract in Ravenstar specifically referred to an 'actual damages' alternative, most of the optional liquidated damages cases reviewed by the author do not.").

provided by law,[28] to "proceed at law,"[29] to enforce rights "under this contract,"[30] or the like.

Sometimes, a purchase and sale agreement will simply refer to the seller's right to retain the earnest money deposit as liquidated damages with no reference to "election" or its equivalent.[31] These are not technically election clauses since they do not spell out the seller's right to elect damages in lieu of retaining the deposit; however, some courts have construed them as such.[32] The reasoning is that by failing to designate the retention of the earnest money deposit as the sole and exclusive remedy, a seller has preserved the option of pursuing other remedies that exist at law (*i.e.*, damages or specific performance).[33] Thus, it is not the wording of the clause per se that permits the election of remedies, but the absence of wording that would limit the seller to the

28. *E.g.*, *Aflalo v. Harris*, No. 05-21-01057-CV, 2023 WL 2522206, at *7 (Tex. App. Mar. 15, 2023) ("15. DEFAULT: If Buyer fails to comply with this contract, Buyer will be in default, and Seller may (a) enforce specific performance, *seek such other relief as may be provided by law*, or both, or (b) terminate this contract and receive the earnest money as liquidated damages, thereby releasing both parties from this contract." (emphasis added)); *Mountain Courtyard Suites v. Wysong*, 452 F. Supp. 3d 1275, 1280 (D. Utah 2020) ("DEFAULT. If Buyer defaults, Seller may elect either to retain the Earnest Money Deposit as liquidated damages, or to return it and sue Buyer to specifically enforce this Contract or pursue other remedies available at law." (emphasis omitted)).

29. *Lefemine v. Baron*, 573 So. 2d 326, 327–28 (Fla. 1991) ("1. DEFAULT BY BUYER: If Buyer fails to perform the Contract within the time specified, the deposit(s) made or agreed to be made by Buyer may be retained or recovered by or for the account of Seller as liquidated damages, . . . or Seller, at his option, *may proceed at law* or in equity to enforce his rights under the Contract." (emphasis added)).

30. *Cloud v. Schenck*, 869 So. 2d 709, 710 (Fla. Dist. Ct. App. 2004) ("If BUYER fails to perform this contract within the time specified, the deposit paid by BUYER may be retained by or for the account of SELLER as agreed upon liquidated damages . . . OR SELLER at SELLER's option, may proceed to enforce SELLER's rights *under this contract*." (emphasis added)).

31. *See Arena v. Heather*, No. 6112, 1983 WL 13780, at *3 (Ohio Ct. App. Oct. 17, 1983) ("The contract provides, in the event of the buyers' default, that: 'Seller may, in lieu of other remedies available to him, declare this agreement null and void as to buyer, and, at his option, all monies paid on account hereof not in excess of 15% of the agreed purchase price herein shall be forfeited to seller as fixed, stipulated and liquidated damages without proof of loss.'") (cleaned up).

32. *See Shull v. Walcker*, 770 N.W.2d 274, 282 (N.D. 2009) ("Neither of these clauses considers the earnest money provided for in the agreement to be the sole remedy in case of a breach by [buyer].").

33. *Id.* Note that the Uniform Land Transactions Act requires that an election clause be express to be valid. UNIF. LAND TRANSACTIONS ACT § 2-516. (AM. L. INST. & UNIF. L. COMM'N 1977) ("(b) A party entitled to recover under a valid liquidated-damages clause has no other remedy for any breach to which the liquidated-damages clause applies unless other remedies are expressly reserved in the contract.").

liquidated amount.[34] For the purpose of this Article, all such clauses—explicit or implicit—are treated as election clauses.

An important note about the term "election clause." One could refer to the entire clause which provides the option of liquidated or actual damages as an election clause. For instance, a contractual provision which states that the "Seller, in his sole discretion, has the option of retaining the earnest money deposit as liquidated damages or suing for actual damages instead" is an election clause. Alternatively, one could refer to the "or" portion of the clause ("or suing for actual damages instead") as an election clause so as to distinguish it from the liquidated damages portion of the clause. This Article largely uses the term in the latter sense.

Parties have been inserting election clauses into real estate contracts for decades.[35] Indeed, several of the leading cases are from the 1990s;[36] and there are discussions of this issue going back much earlier.[37] Why is this an issue now?

First, there seems to be a renewed interest in issues related to liquidated damages clauses and election clauses as of late. In 2017, the Supreme Court of Idaho decided *Phillips v. Gomez*,[38] where it examined the interplay between an election clause and a provision that referred to the earnest money deposit as "non-refundable."[39] Also in 2017, the Supreme Court of Colorado decided *Ravenstar, LLC v. One Ski Hill Place, LLC*[40] and answered the question of "whether a liquidated damages clause in a contract is invalid because the contract gives the non-breaching party the option to choose between liquidated damages and actual damages."[41] In 2020, a federal district court in Utah examined whether filing suit before returning a buyer's earnest money deposit constituted an election of remedies under the purchase and sale

34. *See, e.g.*, *Shull*, 770 N.W.2d at 282 ("Here, nothing in the agreement's two earnest money clauses precluded [Seller] from seeking additional remedies."); *Avery v. Hughes*, 661 F.3d 690, 694 (1st Cir. 2011).

35. The court in *Osborn v. Dennison* noted that "The issue [of election clauses] lurks in almost every residential real estate transaction in Wisconsin." 768 N.W.2d 20, 22 (Wis. 2009). It is probably safe to say that this issue looms large in real estate contracts throughout the United States.

36. *Lefemine v. Baron*, 573 So. 2d 326, 330 (Fla. 1991); *Grossinger Motorcorp, Inc. v. Am. Nat'l Bank & Tr. Co.*, 607 N.E.2d 1337, 1346 (Ill. App. Ct. 1992).

37. *See, e.g.*, *Se. Land Fund, Inc. v. Real Est. World, Inc.*, 227 S.E.2d 340, 344 (Ga. 1976); *Jarro Bldg. Indus. Corp. v. Schwartz*, 281 N.Y.S.2d 420, 426 (App. Term 1967).

38. 405 P.3d 588 (Idaho 2017).

39. *Id.* at 591.

40. 401 P.3d 552 (Colo. 2017).

41. *Id.* at 554.

agreement.[42] And in late 2022, the Supreme Court of Utah considered the selfsame issue when it decided *Rocky Mountain Hospitality, LLC v. Mountain Classic Real Estate, Inc*.[43] Clearly the issue is surfacing more and more and, in many cases, courts are treading new ground.

Second, lawyers and prospective homebuyers do not seem to realize that these election clauses exist and/or that they are potentially enforceable. Speaking of the recent *Ravenstar* decision, one real estate practitioner remarked that the "case was a surprise to a number of lawyers, including the author, who had assumed that such an option [to recover damages] could invalidate a liquidated damages clause because it reflects a lack of intent to liquidate damages."[44] He noted that he "was even more surprised to learn" that courts in multiple states had reached a similar conclusion.[45] This disconnect apparently "prompted the . . . American College of Real Estate Lawyers (ACREL) to seek a better understanding of the disparate treatment of optional liquidated damages in the United States."[46]

Third, the sums at stake are getting larger. Oftentimes, the difference between the earnest money deposit and actual damages is hundreds of thousands of dollars. For instance, in *Aflalo v. Harris*,[47] the buyers put down an earnest money deposit of $10,000 on a $1.45 million property.[48] They purported to terminate the contract but did so after the contractual deadline had expired and thus were deemed to be in breach.[49] The seller sued for actual damages, which the seller claimed to be over $300,000.[50] Similarly, in *Mountain Courtyard Suites v. Wysong*,[51] the buyer entered into an agreement to purchase the defendants' commercial property for $5.95 million, putting down a $100,000 earnest money payment.[52] When the buyer breached the contract, the sellers sought damages of $600,000 pursuant to the election clause in the contract.[53] And in *Rocky Mountain Hospitality, LLC v. Mountain Classic Real Estate, Inc.*, the buyer put down an earnest money deposit of $30,000 on

42. *Mountain Courtyard Suites v. Wysong*, 452 F. Supp. 3d 1275, 1280–81 (D. Utah 2020).
43. 523 P.3d 187 (Utah 2022).
44. Carey, *supra* note 27, at 24.
45. *Id.*
46. *Id.*
47. No. 05-21-01057-CV, 2023 WL 2522206 (Tex. App. Mar. 15, 2023).
48. *Id.* at *1.
49. *Id.*
50. *Id.* at *4.
51. 452 F. Supp. 3d 1275 (D. Utah 2020).
52. *Id.* at 1277.
53. *Id.* at 1281.

a motel property it purchased for $3.4 million.[54] When the buyer ultimately defaulted, the seller sought twenty-six times that amount—$780,000—in damages.[55]

Finally, recent drastic shifts in the real estate market[56] make this issue ripe for consideration (or reconsideration, in jurisdictions that already have settled law on the topic). During the COVID-19 pandemic, the real estate market in the United States went berserk.[57] Many homes received dozens of offers and sold for well over already-aggressive asking prices.[58] Inventory was extremely limited,[59] buyers were plentiful,[60] and interest rates were at historical lows.[61] Realtors said they

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54. 523 P.3d 187, 189 (Utah 2022).

55. *Id. See also Avery v. Hughes*, 661 F.3d 690, 693 (1st Cir. 2011) (seeking $400,000 in damages in a case involving $25,000 earnest money deposit).

56. *See, e.g.*, Christopher Combs, *COVID-19 Addendum to Purchase Contract Is Helpful*, COMBS L. GRP., P.C. (Nov. 22, 2020), https://combslawgroup.com/covid-19-addendum-to-purchase-contract-is-helpful/ [https://perma.cc/2ERW-2KM4] (referring to a COVID-19 era real estate transaction where the seller sought actual damages of $100,000 in lieu of retaining $25,000 earnest money deposit).

57. *See* Jerusalem Demsas, *Covid-19 Caused a Recession. So Why Did the Housing Market Boom?*, VOX (Feb. 5, 2021, 9:00 AM), https://www.vox.com/22264268/covid-19-housing-insecurity-housing-prices-mortgage-rates-pandemic-zoning-supply-demand [https://perma.cc/7TSV-3A32] ("The exploding demand of the past year, in conjunction with a historically low supply of housing, has led buyers to desperately bid up the prices of available properties, sending home prices soaring.").

58. *See* Diana Olick, *The Housing Market Stands at a Tipping Point After a Stunningly Successful Year During the Pandemic*, CNBC, https://www.cnbc.com/2021/03/12/housing-market-covid-one-year-anniversary.html [https://perma.cc/E95P-3DKZ] (Mar. 12, 2021, 3:43 PM) ("The result is that this is currently one of the most competitive housing markets in history."); Adam Wiener, *Home-Buying Demand Passes Pre-Coronavirus Levels; Inventory Down 24%*, REDFIN, https://www.redfin.com/news/homebuying-demand-passes-prepandemic-levels/ [https://perma.cc/7QFG-M5C6] (Oct. 26, 2022) (noting that one agent's client "was in a 24-offer bidding war" for a 1960s home that had never been updated).

59. Inventory continues to be very limited, even in 2024. *See* Alana Semuels, *Why There Are No Houses To Buy in Many U.S. Metro Areas*, TIME (Mar. 9, 2023, 1:24 PM), https://time.com/6261427/current-us-housing-market-inventory-low/ [https://perma.cc/9DE7-V587?type=image]; Robin Rothstein & Caroline Basile, *Housing Market Predictions for 2024: When Will Home Prices Be Affordable Again?*, https://www.forbes.com/advisor/mortgages/real-estate/housing-market-predictions/ [https://perma.cc/JG5B-K7VU] (Feb. 22, 2024, 12:59 PM).

60. Richard Fry, *Amid a Pandemic and a Recession, Americans Go On a Near-Record Homebuying Spree*, PEW RSCH. CTR. (Mar. 8, 2021), https://www.pewresearch.org/short-reads/2021/03/08/amid-a-pandemic-and-a-recession-americans-go-on-a-near-record-homebuying-spree/ [https://perma.cc/8LCJ-RZ9M].

61. Diana Olick, *Mortgage Rates Set New Record Low, Falling Below 3% as Concerns Rise About Coronavirus Second Wave*, CNBC, https://www.cnbc.com/2020/06/11/mortgage-rates-set-new-record-low-fall-below-

had never seen anything like it.[62] But, by the fall of 2022, things started to cool.[63] This was driven by a variety of factors, not the least of which was the rapidly increasing federal interest rate hikes, which trickled down into mortgage rates.[64] In January 2021, a prospective homebuyer could get a mortgage at 2.65 percent interest;[65] by October 2022, that number skyrocketed to over seven percent.[66] Buyers began to exit the real estate market, and prices (and home values) fell.[67]

Buyers who signed purchase and sale agreements as the real estate market softened likely found themselves in a position where they overpaid for the property, putting pressure on them to breach their

3percent-on-coronavirus-fears.html [https://perma.cc/2J9D-N8EC] (June 12, 2020, 8:10 PM).

62. *See* Semuels, *supra* note 59.

63. *See* Dawn Allcot, *2023's Housing Correction Could Be the Largest Since Post-WWII*, YAHOO! LIFE (June 27, 2023), https://ca.style.yahoo.com/2023-housing-correction-could-largest-165335648.html [https://perma.cc/V6GY-7ZEG]; Devon Thorsby, *What Is a Housing Market Price Correction?*, U.S. NEWS & WORLD REP.: REAL EST. (Nov. 10, 2022, 2:21 PM), https://realestate.usnews.com/real-estate/articles/what-is-a-housing-market-price-correction [https://perma.cc/KLM9-CN4A].

64. Patrick S. Duffy, *When Will the Housing Market Crash?*, U.S. NEWS & WORLD REP., https://realestate.usnews.com/real-estate/articles/when-will-the-housing-market-crash [https://perma.cc/PQ2Z-K6H3] (Feb. 21, 2024, 4:25 PM).

65. Demsas, *supra* note 57.

66. Phil Rosen, *US Home Prices Could Tumble Nearly 20% and Fed Economists Warn Further Rate Hikes Risk an Even Worse Housing Correction: 'The Bubble Hypothesis Merits Attention*,*'* BUS. INSIDER: MKTS. INSIDER (Feb. 28, 2023, 11:56 AM), https://markets.businessinsider.com/news/stocks/housing-crash-home-prices-fed-economists-market-correction-bubble-property-2023-2 [https://perma.cc/25X4-NT25].

67. Ken Sweet, Michael Casey & Alex Veiga, *High Mortgage Rates, Prices Discourage Buyers and Chill Housing Market*, PBS (July 21, 2022, 1:36 PM), https://www.pbs.org/newshour/economy/high-mortgage-rates-prices-discourage-buyers-and-chill-housing-market.

contracts.[68] Buyer's remorse,[69] appraisal shortfalls,[70] and mortgage rate increases[71] were the primary reasons behind the impetus to walk away from a binding purchase and sale agreement. Indeed, Redfin estimates that in August 2023, about 60,000 purchase agreements fell through.[72] One online publication observes that "[a] few months ago, buyers would do just about anything to snag a home. Now, they're reneging on deals at the highest rate seen in years."[73] In this sort of market, the actual damages suffered by the seller may be higher than the buyer's earnest money deposit.[74] It is precisely where there is a downturn

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68. Madison Hart, *Buyer Breach of Contract in a Decreasing Price Environment: Seller Remedies*, FIRSTTUESDAY J. (July 15, 2022), https://journal.firsttuesday.us/buyer-breach-of-contract-in-a-decreasing-price-environment-seller-remedies/84530/ [https://perma.cc/VS92-WPKN] ("With the jump in interest rates and downward sloping home sales volume, home prices are expected to decrease heading into 2023. As prices slide, buyers under contract will spot equivalent homes listed for less and realize they have overpaid. Their reaction will be to pull out and buy the less expensive house — or simply wait for the market to bottom." (emphasis omitted)).

69. Lorie Konish, *72% of Recent Homebuyers Have Regrets About Their Purchases. As the Market Cools, These Steps Can Help You Avoid Disappointment*, CNBC, https://www.cnbc.com/2022/08/23/why-recent-homebuyers-have-regrets-about-their-purchases.html [https://perma.cc/3UXT-X57Z] (Aug. 23, 2022, 6:23 PM); Serah Louis, *'I Was Kind of Swept Up': Nearly 3 in 4 Homebuyers Who Bought During the Pandemic Regret It Now—Here's How To Ensure You're Not One of Them*, YAHOO! FIN. (Jan. 15, 2023), https://finance.yahoo.com/news/didnt-want-wait-too-long-130000623.html [https://perma.cc/BB6R-V5RE].

70. James Bradshaw, *Rapid Increase in Home Prices Puts Buyers in Bind When Appraisals Don't Match Sale Price*, GLOBE & MAIL (Apr. 5, 2021), https://www.theglobeandmail.com/business/article-rapid-increase-in-home-prices-puts-buyers-in-bind-when-appraisals-dont/; Shawn Telford, *Appraisal Gap Increases in "Hot" Markets*, CORELOGIC (July 29, 2021), https://www.corelogic.com/intelligence/appraisal-gap-increases-in-hot-markets/ [https://perma.cc/6NRX-5VCF].

71. Chris Arnold, *Some Homebuyers Lose Deposits of $10,000, $20,000, or More Due to High Mortgage Rates*, NPR (Nov. 16, 2022, 7:00 AM), https://www.npr.org/2022/11/16/1135838986/some-homebuyers-lose-deposits-of-10-000-20-000-or-more-due-to-high-mortgage-rate [https://perma.cc/YFW2-HCD9]; Sweet, Casey & Veiga, *supra* note 67 ("Besides pushing would-be homeowners to reconsider their home search, rising rates are also forcing a growing number of buyers who struck a deal on a house to back out.").

72. Lily Katz, *Home Purchases Fell Through at the Highest Rate in Nearly a Year in August*, REDFIN (Sept. 15, 2023), https://www.redfin.com/news/housing-market-tracker-august-2023/ [https://perma.cc/5X55-9F8Y]. This represents 15.7 percent of homes that went under contract in August and marks the highest percentage of cancellations since October 2022. *Id.*

73. Aly J. Yale, *5 Reasons Home Sales Keep Falling Through — and How Sellers Can Prevent It*, MONEY (Oct. 13, 2022), https://money.com/why-home-sales-are-falling-through/ [https://perma.cc/E9DY-6C2F].

74. In normal circumstances, the earnest money deposit is more than sufficient to cover the seller's losses. *See* Monestier, *supra* note 18, at 1212 ("The reality, however,

in the real estate market that the issue of electing between liquidated and actual damages comes into sharp focus.[75]

II. SETTING THE STAGE: UPHOLDING THE LIQUIDATED DAMAGES CLAUSE *OR* UPHOLDING THE ELECTION CLAUSE?

There are two distinct contexts in which the election clause issue arises. The first is where a buyer is looking to invalidate the liquidated damages clause and seeks a return of his earnest money deposit. For instance, in *Ravenstar, LLC v. One Ski Hill Place*, the buyer sought a return of its fifteen percent earnest money deposit after it failed to complete its agreed-upon purchase of the seller's property.[76] The buyer argued that the liquidated damages clause in the contract was "invalid as a matter of law because an option to select between remedies necessarily means that the parties did not intend to liquidate damages and thus the liquidated damages clause operates as an invalid penalty."[77] Because the fifteen percent liquidated damages clause was a penalty, the buyer argued, the clause should not be enforced and the seller should be limited to recovering its actual damages instead.[78] In *Ravenstar*, the court disagreed with the buyer and held that an election clause does not invalidate a liquidated damages clause or render it a penalty.[79] In these cases, the focus is on what effect a clause that provides the seller with a choice to elect damages has on the enforceability of the liquidated damages clause itself. If a buyer convinces a court that the presence of an election clause renders an otherwise-valid liquidated damages clause a penalty, then the remedy is to strike the liquidated damages clause and limit the seller to proving actual damages (if any).[80]

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is that the current practice of validating the forfeiture of almost any deposit means that buyers suffer very real losses, while sellers often walk away with a huge windfall. That is not to say that sellers do not suffer harm when a buyer breaches a contract, but that harm is rarely anywhere close to amount of the buyer's deposit.").

75. For a rough parallel in the 2008–09 subprime real estate market, see, for example, *Ner Tamid Congregation of N. Town v. Krivoruchko*, No. 08 C 1261, 2010 WL 391611, at *1 (N.D. Ill. Feb. 3, 2010).

76. 401 P.3d 552, 553–54 (Colo. 2017).

77. *Id.* at 554. *See also Grossinger Motorcorp, Inc. v. Am. Nat'l Bank & Tr. Co.*, 607 N.E.2d 1337, 1346 (Ill. App. Ct. 1992) ("Plaintiff's primary challenge to the liquidated damages provision's enforceability is that, under these circumstances, the provision's optional nature constitutes a penalty. Plaintiff would contend that by reserving the option to seek compensatory damages, defendant intends for the liquidated damages option to operate only where it exceeds actual damages.").

78. *Ravenstar*, 401 P.3d at 554.

79. *Id.* at 553–54.

80. *See Lefemine v. Baron*, 573 So. 2d 326, 329–30 (Fla. 1991) (holding that the liquidated damages clause was a penalty as a matter of law).

The other context in which this issue presents itself is where a buyer seeks to uphold the liquidated damages clause and preclude the seller from pursuing actual damages. A buyer may do so in one of two ways. First, a buyer may argue that a seller's retention of the earnest money deposit after filing suit constitutes an irrevocable election of liquidated damages as the seller's sole and exclusive remedy.[81] This ultimately becomes a factual issue—at what point does retention of an earnest money deposit mean that you have "elected" liquidated damages as your remedy and are therefore foreclosed from pursuing actual damages?[82] Alternatively, a buyer may argue that a liquidated damages clause is fundamentally incompatible with an election clause, and that the latter should be stricken from the contract.[83] This would mean that recovery is capped at the amount of the earnest money deposit. This is the trickier conceptual issue as it requires courts to grapple with whether an election clause can meaningfully coexist with a liquidated damages clause.

The two scenarios above are essentially flipsides of each other. In the first scenario, actual damages are lower than the earnest money deposit (or possibly zero). In this case, the seller wants to retain the earnest money deposit and the buyer wants to invalidate the liquidated damages clause and have the earnest money returned to him. In the second scenario, actual damages are higher than the earnest money deposit. Accordingly, the seller wants to opt for actual damages pursuant to the election clause and the buyer wants to limit the seller to the earnest money deposit. Fundamentally, though, both scenarios raise the same issue: Are election clauses valid? And if not, what should courts do when election clauses appear in contracts?

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81. *Rocky Mountain Hosp., LLC v. Mountain Classic Real Est., Inc.*, 523 P.3d 187, 192 (Utah 2022).

82. For instance, in *Rocky Mountain Hospitality*, the seller opted to pursue actual damages instead of liquidated damages pursuant to an election clause. *Id.* at 189. The buyer moved to dismiss, arguing that the seller had "elected" to retain the $30,000 earnest money deposit as its remedy because it failed to return the deposit prior to filing suit. *Id.* The Utah Supreme Court agreed. *Id.* at 192–93. It noted that the seller "maintained constructive control of the deposit" for thirty-six days after filing suit. *Id.* at 192. By doing so, the seller "chose to relinquish the opportunity to seek other remedies—even if Seller did so inadvertently." *Id.* at 193. *See also Brackelsberg v. Heflin*, 386 S.W.3d 636, 638 (Ark. Ct. App. 2011) ("We held that reasonable minds could reach different conclusions about whether the Brackelsbergs' handling of the earnest money—not returning it when the deal collapsed and keeping it for more than a year thereafter—established an election to keep the $5000.00 as liquidated damages and move on.").

83. *See Avery v. Hughes*, 661 F.3d 690, 694 (1st Cir. 2011).

Courts diverge on whether election clauses are enforceable.[84] Some courts say no, reasoning that such clauses are inconsistent with the very nature of a liquidated damages clause.[85] But a surprising number of courts are prepared to recognize the validity of an election clause, whether it means allowing a liquidated damages clause to stand even though it arguably constitutes a penalty or allowing a seller to opt for actual damages pursuant to the clause.[86] These courts see no problem with the two clauses coexisting and letting a seller choose his remedy after a breach. The logic used by courts in both contexts is similar and rests on the idea that if parties have signed a contract containing an election clause, they should be bound by it. But the logic is seriously flawed and fails to adequately consider the doctrinal and practical interplay between liquidated damages and election clauses. Below, Parts III and IV consider the logic underpinning both scenarios: courts upholding a liquidated damages clause in the face of an election clause, and courts upholding an election clause in the face of a liquidated damages clause.

III. DEBUNKING COURTS' LOGIC PART I: UPHOLDING A LIQUIDATED DAMAGES CLAUSE IN THE PRESENCE OF AN ELECTION CLAUSE

Most cases considering the validity of election clauses have been in the context of a buyer seeking to invalidate a liquidated damages clause owing to the presence of an election clause in the contract. The reasoning in these sorts of cases is very simple: the election clause is enforceable because you agreed to it, and nothing about the presence of the election clause renders the liquidated damages clause an unenforceable penalty.

The Supreme Court of Colorado's decision in *Ravenstar, LLC v. One Ski Hill Place, LLC* typifies the logic used in these cases. In that case, the parties entered into a purchase and sale agreement which provided that if the buyer breached, the seller could either retain the earnest money deposit as liquidated damages or sue for actual damages

84. WILLISTON ON CONTRACTS, *supra* note 22, § 65:32 ("The issue of the right of a party for whose benefit a liquidated damages provision exists to choose between its benefits and proceeding to recover its actual damages is one with respect to which some inconsistency appears in the decisions.").

85. *Lefemine*, 573 So. 2d at 329.

86. ROGER A. CUNNINGHAM, WILLIAM B. STOEBUCK & DALE A. WHITMAN, THE LAW OF PROPERTY 680 (2d ed. 1993). *See also* Carey, *supra* note 27, at 24 ("This case [*Ravenstar*] was a surprise to a number of lawyers, including the author, who had assumed that such an option could invalidate a liquidated damages clause because it reflects a lack of intent to liquidate damages. The author was even more surprised to learn that the Colorado Supreme Court is not the only court to uphold an optional liquidated damages clause: courts in several states have reached a similar conclusion.").

instead.[87] The seller opted for the former.[88] The buyer then challenged the earnest money deposit provision as being unenforceable, arguing that the presence of an option to elect damages rendered the liquidated damages provision a penalty.[89] The court framed the issue as "whether a liquidated damages clause in a contract is invalid because the contract gives the non-breaching party the option to choose between liquidated damages and actual damages."[90]

The court began by noting that "the only contested element is whether the parties intended to liquidate damages."[91] It then stated that "[t]he presence of a liquidated damages provision 'itself is evidence of the parties' intention to liquidate damages in advance.'"[92] The court further observed that it "ha[d] never determined whether the presence of an alternative damages remedy negates the required intent to liquidate damages and therefore invalidates a liquidated damages clause."[93] The court in *Ravenstar* began (and largely ended) its analysis by espousing the importance of freedom of contract.[94] It reasoned that "the parties here were free to bargain for liquidated damages as a sole and exclusive remedy, but they did not, and instead bargained for the risk allocation memorialized in the Damages Provision currently in the Agreements."[95] The court indicated that "[s]triking the option to liquidate damages . . . would be antithetical to the principles of freedom of contract and would require us to restructure the contract, which we are reluctant to do."[96]

The court then tackled the core argument advanced by the buyer: that the presence of an election clause demonstrates that the parties did not intend to liquidate damages. On this point, the court stated that "[t]he freedom to contract for the alternative damages remedies of liquidated damages and actual damages does not negate the parties' intent to liquidate damages."[97] It emphasized that "[a]n intent to liquidate damages should not be conflated with an intent to liquidate damages as the sole and exclusive remedy."[98]

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87. *Ravenstar, LLC v. One Ski Hill Place, LLC*, 401 P.3d 552, 553 (Colo. 2017).
88. *Id.* at 554.
89. *Id.*
90. *Id.* at 553.
91. *Id.* at 555.
92. *Id.*
93. *Id.*
94. *Id.* at 555, 558.
95. *Id.* at 556.
96. *Id.*
97. *Id.*
98. *Id.*

Ultimately, the court was not persuaded by precedent in other jurisdictions that had viewed the presence of an election clause as defeating the intent to liquidate damages. The logic employed by those courts focused on the fact that a seller would only choose liquidated damages where actual damages are lower than the liquidated amount, thereby penalizing a buyer in every case.[99] The court in *Ravenstar* thought otherwise, noting that a seller might reasonably choose to retain the earnest money as liquidated damages even though actual damages may be higher—either because actual damages are difficult to prove/quantify or because the seller might prefer to avoid litigation.[100]

To understand the flaws in the *Ravenstar* Court's logic, it is helpful to return to first principles. A liquidated damages clause is enforceable if it represents the parties' reasonable attempt to pre-estimate damages in the event of a breach.[101] But a liquidated damages clause is not enforceable if it functions to penalize a party for breach (or, otherwise stated, acts as a breach deterrent).[102] Courts are tasked with figuring out where the dividing line is between a genuine pre-estimate of harm and a penalty.[103] They generally use a three-part test to do so: (1) Did the parties intend to liquidate damages? (2) Were damages uncertain and/or difficult to ascertain? (3) Does the liquidated damages amount represent a reasonable forecast of harm?[104] When it comes to the interplay between liquidated damages clauses and election clauses, the focus is on the first prong: Did the parties intend to liquidate damages? A clause which purports to preserve a right to actual damages does not evidence an intention to liquidate damages. Instead, it evidences an intention to set a

99. *Id.* at 557.

100. *Id.*

101. *See, e.g.*, *Kelly v. Marx*, 705 N.E.2d 1114, 1117 (Mass. 1999) ("This approach most accurately matches the expectations of the parties, who negotiated a liquidated damage amount that was fair to each side based on their unique concerns and circumstances surrounding the agreement, and their individual estimate of damages in event of a breach."); *Watson v. Ingram*, 851 P.2d 761, 765 (Wash. Ct. App. 1993) ("The amount of the deposit represents the parties' agreement about what will serve as sufficient liquidated damages for a breach."), *aff'd*, 881 P.2d 247 (Wash. 1994).

102. 22 AM. JUR. 2D *Damages* § 507 (2013) ("Where parties stipulate as to the amount of damages due in the event of contractual breach, and the stipulation is not based upon contemplated actual damages but is intended to provide punishment for breach of the contract, it is a 'penalty'; where parties stipulate as to the amount of damages due in the event of contractual breach, and the stipulation is reasonably intended by the parties as the predetermined measure of compensation for actual damages that might be sustained by reason of nonperformance, the stipulation is for 'liquidated damages.'").

103. *See Dean V. Kruse Found., Inc. v. Gates*, 973 N.E.2d 583, 592 (Ind. Ct. App. 2012) ("However, despite the plethora of abstract tests and criteria for the determination of whether a provision is one for a penalty or liquidated damages, there are no hard and fast guidelines to follow.").

104. Monestier, *supra* note 18, at 1161, 1164–65.

minimum floor for recovery, irrespective of loss—the very definition of a penalty.[105]

The *Ravenstar* Court's response to this argument was to insist that "[a]n intent to liquidate damages should not be conflated with an intent to liquidate damages as the sole and exclusive remedy."[106] It stated that "[t]he parties must only mutually intend to make liquidated damages one of the available remedies that the non-breaching party could pursue."[107] The *Ravenstar* Court erroneously regarded the "intent" element in the test for liquidated damages as akin to mutual assent in contract formation: Is there evidence that the parties mutually agreed to this? The court repeated a variation of the phrase "mutual intent" three times in a mere two sentences:

> The parties must only *mutually intend* to make liquidated damages one of the available remedies that the non-breaching party could pursue. So long as the parties *mutually intend* the stipulated sum to be the agreed-upon measure of damages if the non-breaching party elects liquidated damages, the *mutual intent* element . . . is satisfied.[108]

This passage reveals that the court completely misapprehended the "intent" element in the doctrinal test for the enforceability of liquidated damages. Its logic is that the parties mutually intended to liquidate damages because they mutually *agreed* to include the clause in the contract.[109] Instead, the intent prong focuses on a completely different question: whether the parties, by selecting the amount in question, intended to liquidate damages or whether they intended to set a penalty for breach.[110] The purpose of this part of the test is to ascertain whether there is *something* to indicate that the parties, in setting the number they did, intended the clause to function as a penalty and not a genuine pre-

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105. *See Lefemine v. Baron*, 573 So. 2d 326, 329 (Fla. 1991).

106. *Ravenstar, LLC v. One Ski Hill Place, LLC*, 401 P.3d 552, 556 (Colo. 2017).

107. *Id.*

108. *Id.* (emphasis added).

109. Indeed, this is consistent with the rest of the *Ravenstar* Court's reasoning which largely focuses on freedom of contract. *See supra* notes 87–100 and accompanying text.

110. 24 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 65:16, Westlaw (database updated May 2023) ("To determine the reasonableness of a stipulated-damages clause, the courts consider (1) whether the parties intended to provide for damages or for a penalty; . . . .").

estimate of harm.[111] For instance, if the clause itself refers to it being a "penalty," a court may conclude that the parties did not intend the number to represent an attempt to pre-estimate damages in the event of breach.[112] Alternatively, in some cases, the number is so high and unrelated to any potential losses that courts almost automatically conclude that the number was intended as a penalty.[113] In short, the purpose of this prong of the test is not to determine whether the parties "agreed" to the provision, but whether the parties intended the number to approximate anticipated harm owing to a potential breach.[114]

Where a party couples a liquidated damages clause with an election clause, this automatically negates an intention to pre-estimate damages.[115] Instead, the clause operates as a de facto penalty because it guarantees a minimum recovery to the non-breaching party, even if there is no harm. The leading case espousing this view is *Lefemine v. Baron*,[116] where the court stated:

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111. Tess Wilkinson-Ryan, *Do Liquidated Damages Encourage Breach? A Psychological Experiment*, 108 MICH. L. REV. 633, 643 (2010) ("[A] liquidated-damages clause is invalid if it has the intent or the function of punishing the breacher.").

112. WILLISTON ON CONTRACTS, *supra* note 22, § 65:9 ("Though the parties to a contract who use the words 'penalty' or 'liquidated damages' may prima facie be supposed to mean what they say, yet the expression used is not conclusive. The court must find out whether the payment stipulated is in truth a penalty or liquidated damages.").

113. *Id.* § 65:16 ("[T]he primary question seems to be whether the parties honestly endeavored to fix a sum equivalent in value to the harm caused by the breach, but . . . the only real means of determining whether the parties in good faith endeavored to assess the damages is afforded by the amount of damages stipulated for, and the nature of the breach . . . . This is saying in other words that the reasonableness or unreasonableness of the stipulation is decisive, and that an unreasonable stipulated amount is by itself a basis sufficient to support the conclusion that the amount stipulated was intended to act as a penalty, and is thus unenforceable." (footnotes omitted)).

114. *Id.* § 65:11 ("With respect to the matter of stipulated-damages clauses, in every case, whether the clause is for legal purposes an unenforceable penalty or an enforceable liquidated damages clause, the parties have manifested a clear intention that the sum stated in the contract shall be paid on the occurrence of a particular contingency, and that is the only intention they have manifested. If this 'intention' were given effect, every such clause would be enforced. However, this is obviously not the case . . . .").

115. *Grossinger Motorcorp, Inc. v. Am. Nat'l Bank & Tr. Co.*, 607 N.E.2d 1337, 1346 (Ill. App. Ct. 1992) ("As previously noted, the first consideration in determining whether a liquidated damages provision is enforceable is whether the parties intended to agree in advance to the settlement of damages that might arise from the breach. On its face, the optional nature of the liquidated damages clause shows that the parties never intended to establish a specific sum to constitute damages in the event of a breach." (citation omitted)).

116. 573 So. 2d 326 (Fla. 1991).

> The reason why the forfeiture clause must fail in this case is that the option granted to [seller] either to choose liquidated damages or to sue for actual damages indicates an intent to penalize the defaulting buyer and negates the intent to liquidate damages in the event of a breach. The buyer under a liquidated damages provision with such an option is always at risk for damages greater than the liquidated sum. On the other hand, if the actual damages are less than the liquidated sum, the buyer is nevertheless obligated by the liquidated damages clause because the seller will take the deposit under that clause. Because neither party intends the stipulated sum to be the agreed-upon measure of damages, the provision cannot be a valid liquidated damages clause.[117]

Perhaps courts would be more attuned to this argument if the labels "liquidated damages" and "election clause" were not used, because they may obfuscate what is really going on in these cases. Consider the following hypothetical provision: "Seller is entitled to full damages, including consequential damages, if Buyer breaches the contract. However, should Seller choose not to prove actual damages, Seller will automatically be entitled to a sum of $100,000." This clause makes plain what is going on here. The seller is setting a guaranteed minimum recovery. If there are no damages, the seller will elect the liquidated amount, which functions to punish the buyer for breaching the contract. If the liquidated amount is insufficient to cover the seller's losses, he will elect actual damages, all while assuming no downside risk. This sentiment is summed up nicely by the court in *Catholic Charities of the Archdiocese of Chicago v. Thorpe*[118]:

> The preservation of an option to alternatively seek the recovery of actual damages reflects that the parties did not have the mutual intention to stipulate to a fixed amount as their liquidated damages, but rather to a *minimum amount subject to*

117. *Id.* at 329–30. *See also Grossinger Motorcorp,* 607 N.E.2d at 1346 ("On its face, the optional nature of the liquidated damages clause shows that the parties never intended to establish a specific sum to constitute damages in the event of a breach."); *Rogers v. Lockard*, 767 N.E.2d 982, 992 (Ind. Ct. App. 2002) ("Here, the Agreement does not give the [seller] a choice of liquidated damages or other legal remedies, but instead says buyer 'forfeits' the earnest money *and* the seller may pursue other legal and equitable remedies. If this were allowed, and that is what actually happened here, then the forfeiture of the earnest money acts as a punishment for breach of the contract, and not as an estimation of the actual damages. Thus, the 'liquidated damages' were in fact a penalty and should not be recoverable.").

118. 741 N.E.2d 651 (Ill. App. Ct. 2000).

> *increase* if actual damages prove to exceed the amount provided as liquidated damages. In effect, the manifest purpose of the liquidated damages provision under such circumstances is to give the seller the option of penalizing the buyer by recovering an amount in excess of his actual damages where the actual damages are less than the liquidated sum.[119]

That a seller may reasonably choose to retain the earnest money deposit even though actual damages may be higher—as the court in *Ravenstar* suggested—does not render the liquidated damages clause less of a penalty. Any liquidated damages clause which is coupled with an election clause is a penalty as a matter of law because it demonstrates the parties' intent at the time of contract formation to set a minimum quantum of damages irrespective of loss.[120]

There is another conceptual problem at the confluence of election clauses and liquidated damages clauses. One of the requirements of a liquidated damages clause is that damages must be uncertain or difficult to ascertain.[121] Where a seller sets a monetary amount in the form of a liquidated damages clause (or earnest money deposit), and then preserves the right to pursue actual damages, this is an implicit acknowledgement that damages are not too uncertain or difficult to ascertain.

Ultimately, adding an election clause to a contract that contains a liquidated damages clause destroys the fundamental character of the latter.[122] A liquidated damages clause can stand only if it is not a penalty. Where a seller preserves the right to pursue actual damages, then the liquidated damages clause will kick in only where it would constitute a penalty (*i.e.*, where the liquidated damages amount is higher than the actual damages suffered by the seller). A seller clearly does not intend to liquidate damages where he has preserved actual damages as a back-up plan.

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119. *Id.* at 657 (emphasis added).

120. *See Mineo v. Lakeside Vill. of Davie, LLC*, 983 So. 2d 20, 22 (Fla. Dist. Ct. App. 2008) ("The ability of the seller to refuse to be limited to the deposit paid by the buyer as a liquidated amount, and to sue for damages, destroyed the character of the forfeiture as agreed damages, and the forfeiture became a penalty.").

121. Shiffrin, *supra* note 23, at 415 ("Thus, two elements must be met before the clauses are enforceable: first, actual damages must be 'uncertain' or difficult to quantify; second, the specified remedy must be a reasonable approximation of the (uncertain) damages and, in particular, it must not be a penalty." (footnotes omitted)).

122. *Olen Residential Realty Corp. v. Romine*, No. 502004CC001245XXXXMB, 2004 WL 3322327, at *2 (Fla. Cir. Ct. May 27, 2004) ("An option granted to the landlord to either choose liquidated damages or to sue for actual damages and thus become entitled to damages greater than the liquidated sum, destroys the character of the 'liquidated damage' clause such that it becomes a penalty.").

IV. DEBUNKING COURTS' LOGIC PART II: UPHOLDING AN ELECTION CLAUSE IN THE PRESENCE OF A LIQUIDATED DAMAGES CLAUSE

Much like the scenario where a buyer seeks to invalidate a liquidated damages clause, courts allowing a seller to pursue actual damages focus almost exclusively on the language of the contract. If the contract permits a seller to elect actual damages, the seller may elect actual damages. Indeed, most of the cases that fall into this category have validated election clauses without even recognizing the apparent tension between liquidated damages clauses and the right to seek actual damages.[123]

In *Avery v. Hughes*,[124] for instance, the seller sought actual damages in lieu of retaining the buyer's $25,000 deposit.[125] The First Circuit Court of Appeals viewed the issue strictly in terms of contractual interpretation: the contract unambiguously permitted the seller to elect actual damages instead of liquidated damages. The court indicated that "black-letter law [was] dispositive here."[126] It noted that "Paragraphs 14 and 17, whether taken singly or in combination, are free from ambiguity because they can reasonably be read in only one way."[127] The court stated that "Paragraph 14 is written with conspicuous clarity. It gives the seller the *option* to decide whether it wishes to retain the deposit as liquidated damages. That language is clear as a bell."[128] It then reasoned that the "nonrefundability language [in Paragraph 17] does not limit the option granted to the seller under Paragraph 14."[129] Thus, for the *Avery* Court, the contractual language was the be-all and end-all of the analysis.

The analysis is very similar in other cases where the issue has been presented. In *Margaret H. Wayne Trust v. Lipsky*,[130] the seller of a condominium brought an action against the breaching buyer to recover damages instead of retaining the $1,000 earnest money deposit.[131] Even though the clause at issue was "poorly written," the court concluded that

123. The focus in most of these cases is on whether the seller has "elected" liquidated damages by retaining the earnest money deposit for some period of time after filing suit. *See, e.g.*, *McKeon v. Crump*, 53 P.3d 494, 498 (Utah Ct. App. 2002) (considering arguments related to whether the seller had elected liquidated damages by its actions in not returning the earnest money deposit prior to suit instead of the possibility that the election clause was unenforceable). *Osborn v. Dennison*, 768 N.W.2d 20, 31 (Wis. 2009) (same).

124. 661 F.3d 690 (1st Cir. 2011).

125. *Id.* at 691–93.

126. *Id.* at 694.

127. *Id.*

128. *Id.*

129. *Id.*

130. 846 P.2d 904 (Idaho 1993).

131. *Id.* at 906–07.

"it [was] clear from a reading of the agreement as a whole that the seller [had] the option of accepting the forfeited earnest money as liquidated damages, [or] bringing an action for recovery of actual damages."[132] Thus, because the contract "expressly preserv[ed]" the right to sue for damages, the clause was enforceable.[133] In *Noble v. Ogborn*,[134] the court focused on the "intent" of the parties, as manifested in the agreement: "Noble and Ogborn contracted that Noble shall have the election to retain the earnest money as liquidated damages, 'or to institute suit to enforce any rights seller has.'"[135] The latter expression "includes the right to sue for damages for breach of contract."[136] In *Williams v. Kondziela*,[137] the court allowed the seller to pursue actual damages for breach of a purchase and sale agreement, noting that the "liquidated damages provision was merely a stipulated remedy available to the seller at his option that, if utilized, would preclude alternate remedies."[138] However, "[p]ursuant to the plain language of the contract, appellee was not manacled to liquidated damages in the event of default."[139]

The logic of courts upholding election clauses is rudimentary: These clauses are enforceable because they represent the parties' intent. Freedom of contract demands that courts enforce the contract in front of them.[140] There are two things that courts seem to be missing from the discussion. First, contractual terms are not automatically enforceable because they are written in black and white. And second, one would be hard-pressed to say that an obscure clause in a real estate contract represents the intent of the parties.

First, contractual terms are not enforceable simply because they appear in a contract and the parties have ostensibly agreed to them. Courts routinely deem contractual provisions unenforceable for a variety of reasons: unconscionability, fraud, public policy, and the like.[141] What is most surprising is that courts are failing to appreciate this basic fact in

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132. *Id.* at 908–09.

133. *Id.*

134. 717 P.2d 285 (Wash. Ct. App. 1986).

135. *Id.* at 287.

136. *Id.*

137. No. 2002–L–190, 2004 WL 877727 (Ohio Ct. App. Apr. 23, 2004).

138. *Id.* at *3.

139. *Id.*

140. *See, e.g.*, *Noble*, 717 P.2d at 287 ("[T]he contract in the case sub judice allows [seller] to elect to have liquidated damages or retain all his rights. The meaning and intent of 'any rights seller has' includes the right to sue for damages for breach of contract.").

141. *See* Charles A. Sullivan, *The Puzzling Persistence of Unenforceable Contract Terms*, 70 OHIO ST. L.J. 1127, 1128 (2009) ("Contracts frequently contain clauses that are not enforceable—at least, not enforceable as written.").

a context where it should be readily apparent: that of liquidated damages. With every liquidated damages clause, the task of courts is to determine whether such a provision is, indeed, a valid liquidated damages clause or whether it is an unenforceable penalty.[142] To do so, courts employ a multi-prong test that focuses largely on whether the liquidated number represents a reasonable pre-estimate of harm.[143] Most courts understand that a liquidated damages clause is not enforceable by virtue of its inclusion in a contract and usually subject such clauses to robust scrutiny. Professor Hillman notes that "courts often overturn liquidated damages clauses as 'penalties,' with greater zeal and vigor than they strike other contract terms."[144] This makes the disconnect in logic even more profound. A liquidated damages clause is not automatically enforceable;[145] yet an election clause which appears in tandem with it is. Thus, the first big problem with courts' logic is that they are starting from the wrong premise: that election clauses are enforceable because freedom of contract somehow demands it.

Second, it is disingenuous to speak of party intent in this context. In a typical real estate transaction, the parties use standard forms which tend to favor the seller.[146] It is extremely unlikely that a buyer would understand that his liability could exceed the designated earnest money

142. Larry A. DiMatteo, *Penalties as Rational Response to Bargaining Irrationality*, 2006 MICH. ST. L. REV. 883, 884–85 ("The law of liquidated damages in its simplest form states that clauses imbued with the formal trappings of contract—and to make the case the most clear, even clauses that are products of express negotiation between parties of relatively equal bargaining power—are not to be enforced if the clauses are deemed penalties post hoc." (footnote omitted)).

143. RESTATEMENT (SECOND) OF CONTS. § 356 (AM. L. INST. 1979) ("(1) Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty.").

144. Robert A. Hillman, *The Limits of Behavioral Decision Theory in Legal Analysis: The Case of Liquidated Damages*, 85 CORNELL L. REV. 717, 726 (2000).

145. *See* Larry A. DiMatteo, *A Theory of Efficient Penalty: Eliminating the Law of Liquidated Damages*, 38 AM. BUS. L.J. 633, 638 (2001) ("Hence, the law of liquidated damages severely limits the parties' freedom to agree to pre-set damages in most cases. Unless the clause meets necessary requirements, the parties' pre-agreed remedial response to a breach of contract is replaced by one fashioned by the courts ex post."); Shiffrin, *supra* note 23, at 411 ("Despite the parties' agreement, such clauses are only enforceable under the traditional common law if epistemic difficulties (sometimes actual, sometimes anticipated) preclude damages from being ascertained with certainty. Even then, a resolution previously agreed to by the parties will only be enforceable if it represents a reasonable approximation of actual damages." (footnotes omitted)).

146. *See, e.g.*, *Margaret H. Wayne Tr. v. Lipsky*, 846 P.2d 904, 909 (Idaho 1993) ("Our interpretation is influenced by the fact that this is a standard printed form agreement used in innumerable home purchases every day throughout the state . . . .").

deposit.[147] Recall that these provisions rarely explicitly provide for damages as an alternative to liquidated damages; instead, they vaguely allude to the seller's right to pursue "any remedy at law."[148] This, of course, assumes that the buyer has even read the purchase and sale agreement.[149] In reality, the buyer is unlikely to have gotten into the weeds of the contract.[150] Instead, he is much more preoccupied with the big picture details of the transaction: the appraisal, the mortgage contingency, the inspection, and the like. The court in *McKeon v. Crump*[151] recognized the bait and switch inherent in election clauses, observing that "the attempt to enforce [an election clause] is almost invariably against a purchaser who has been induced to sign it and deposit money under the impression that its forfeiture will be the extent of his loss if he decides not to buy the property."[152] So, as a preliminary matter, all the bluster about "freedom of contract" and "intent of the parties" needs to be taken with a grain of salt.

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147. *Avery v. Hughes*, 661 F.3d 690, 694 (1st Cir. 2011) ("First, [buyer] claims that when he entered into the Agreement he understood paragraphs 14 and 17 to limit his exposure to damages for breach to [his deposit of] $25,000.").

148. *See supra* notes 27–30 and accompanying text. Sometimes, the election clause is even more opaque. *See, e.g.*, *Williams v. Kondziela*, No. 2002–L–190, 2004 WL 877727, at *2 (Ohio Ct. App. Apr. 23, 2004). ("The liquidated damages provision in question states that the seller *may, in lieu of other remedies available,* accept damages for default in an amount not exceeding fifteen percent of the agreed purchase price. The term 'may' implies the exercise of discretion. Consequently, the seller is not required to accept 15% of the agreed purchase price as damages in the event of default. Rather, a seller may use the liquidated damages provision as a mechanism for compensation in the event that he or she does not want to pursue other remedies. The provision does not foreclose the possibility of the seller pursuing alternate remedies.").

149. Shmuel I. Becher & Uri Benoliel, *Dark Contracts*, 64 B.C. L. REV. 55, 58 (2023) ("[C]onsumer standard form contracts repeatedly surprise consumers. To begin with, consumers are unaware of the contract's content. Consumers do not read form contracts, which employ language beyond their literacy levels." (footnotes omitted)); Amy J. Schmitz, *Pizza-Box Contracts: True Tales of Consumer Contracting Culture*, 45 WAKE FOREST L. REV. 863, 878 (2010) ("[C]onsumers have become accustomed to not reading contracts due to limited access, time, and ability to negotiate contract terms. Consumers generally assume that they lack power or contracting choices."); Debra Pogrund Stark & Jessica M. Choplin, *A License To Deceive: Enforcing Contractual Myths Despite Consumer Psychological Realities*, 5 N.Y.U. J.L. & BUS. 617, 655 (2009) ("Although . . . courts generally expect consumers to read and understand the contracts they sign and sometimes penalize the 'negligent' person for failing to do so, in reality . . . a large percentage of consumers do not carefully read the contracts they sign.").

150. *See Parker v. Knauf*, No. CV085007670, 2010 WL 1375564, at *6 (Conn. Super. Ct. Mar. 3, 2010) ("[T]he realtor that represented the defendants was not aware of what a liquidated damage clause was until she was involved in this litigation . . . .").

151. 53 P.3d 494 (Utah Ct. App. 2002).

152. *Id.* at 496.

The more fundamental problem, however, is that many courts have not recognized that the very nature of a liquidated damages clause forecloses the option of an accompanying election clause. The essence of a liquidated damages clause is that it is an *exclusive* remedy—the parties opt to pre-determine damages themselves rather than have a court do it after the fact. In this respect, liquidated damages are a risk-allocation mechanism.[153] The parties decide on a number that they can live with if things go awry. This means that sometimes a buyer will pay more in liquidated damages than he would have if a court assessed actual damages, and sometimes he will pay less.[154] Sometimes the buyer is the beneficiary of the liquidated damages clause and sometimes the seller is. A liquidated damages clause, in other words, is a "for better or worse" scenario where each party takes the good with the bad.[155]

An optional liquidated damages clause is an oxymoron. Liquidated damages are the amount that *will* be paid or *must* be paid in the event of a breach.[156] Liquidated damages are not an amount that *may* be paid unless the non-breaching party decides to opt for more. Indeed, one would be hard-pressed to find any definition or explanation of a liquidated damages clause that suggests that the remedy can be an optional one.

Several courts have recognized that an optional liquidated damages clause is not a liquidated damages clause at all. For instance, in *Sagatov Builders LLC v. Hunt*,[157] the court noted that the "provisions of the

153. Wilkinson-Ryan, *supra* note 111, at 644 ("Professors Goetz and Scott write that a penalty clause may represent the best effort of the parties to allocate risk, especially where a breach may result in noncompensable losses. In this model, the penalty clause serves as a kind of insurance, for which the promisor is the most efficient insurer.").

154. *Karimi v. 401 N. Wabash Venture, LLC*, 952 N.E.2d 1278, 1290 (Ill. App. Ct. 2011) ("The nature of a liquidated damages provision is such that the set amount may at times exceed actual damages, and other times actual damages may exceed the set amount. In entering into the purchase agreement, both parties here agreed to accept this inherent risk.").

155. *Cf. LG Cap. Funding, LLC v. Accelera Innovations, Inc.*, No. 17-CV-1460, 2018 WL 5456670, at *14 (E.D.N.Y. Aug. 13, 2018) ("Otherwise, the liquidated damages provision would be an illusory promise, giving one party the 'option, post-breach, to choose between liquidated or actual damages depending on which is greater, thus defeating the certainty that is the point of liquidated damages provisions.'" (quoting *GFI Brokers, LLC v. Santana*, No. 06 Civ. 3988, 2008 WL 3166972, at *11 (S.D.N.Y. Aug. 6, 2008))).

156. *See* Wilkinson-Ryan, *supra* note 111, at 642 (noting a liquidated damages clause involves the "[p]arties to a contract . . . stipulat[ing] the amount of damages in the event of breach"); Hillman, *supra* note 144, at 725 ("[A]t the time of contracting, parties can agree on the amount of a promisor's damages liability in the event that the promisor breaks the contract.").

157. 88 Va. Cir. 410 (2014).

Contract taken together do not meet the first test or definition of liquidated damages."[158] The court continued:

> It is competent to parties entering on an agreement to avoid all future questions of damage which may result from a violation of the contract, and to agree upon a definite sum as to which shall be paid to the party who alleges and establishes the violation of the agreement. In such a case the damages so fixed are termed liquidated, stipulated or stated damages. Clearly, the damage provision of the Contract does not 'avoid all future questions of damage' and accordingly the option scheme fails to achieve the fundamental purpose of a stipulated damage provision.[159]

Similarly, in *LG Capital Funding, LLC v. Accelera Innovations, Inc.*[160] a federal court noted that a "valid contractual provision for liquidated damages [must] control[] the rights of the parties in the event of a breach."[161] Otherwise, the provision is nothing more than an "illusory promise."[162]

This sentiment is not a new one. In fact, since as early as 1960, courts have recognized that a liquidated damages clause cannot be optional:

> Coming back to the instant case, I find that the clause in question is invalid on its face and unenforceable. It is not a liquidated damage clause at all.
>
> . . . The underlying purpose [of a liquidated damages clause] is to permit parties to look to the future, anticipate that there may be a breach and make a settlement in advance. This implies two things: (1) that the amount specified be a fixed amount and (2) that both parties be bound to that amount. The clause here does not disclose a fixed amount. In essence it fixes

158. *Id.*

159. *Id.* (citation omitted). *See also Ner Tamid Congregation of N. Town v. Krivoruchko*, No. 08 C 1261, 2010 WL 391611, at *4 (N.D. Ill. Feb. 3, 2010) ("These cases rest on the theory that the supposed liquidated damage clause is in fact not a liquidated damage clause at all: '[T]his scheme distorts the very essence of liquidated damages, which in effect is to provide the parties with a pre-ordained settlement of a damage sum when actual damages would otherwise be difficult to determine.'" (quoting *Cath. Charities of the Archdiocese of Chi. v. Thorpe*, 741 N.E.2d 651, at 657 (Ill. App. Ct. 2000))).

160. No. 17-CV-1460, 2018 WL 5456670 (E.D.N.Y. Aug. 13, 2018).

161. *Id.* at *14 (quoting *X.L.O. Concrete Corp. v. John T. Brady & Co.*, 482 N.Y.S.2d 476, 479 (App. Div. 1984), *aff'd*, 489 N.E.2d 768 (N.Y. 1985))).

162. *Id.*

> a minimum which must be paid by the home owner to the contractor, but leaves the door wide open to him to prove actual damage in addition to the so-called liquidated damage. This is no settlement at all and it permits the contractor to have his cake and eat it too.[163]

Indeed, none of the purposes underlying liquidated damages are satisfied if election clauses are given effect: certainty,[164] reduction of litigation,[165] risk allocation,[166] and party autonomy.[167] When an election clause accompanies a liquidated damages clause, there is no certainty for the parties. The buyer is left wondering whether the seller will simply keep the earnest money deposit or whether he will be on the hook for more. The buyer might be in this state of limbo for months or even years.[168] An election clause also encourages litigation. Buyers will rarely stand idly by and voluntarily pay an amount significantly more than they thought they had agreed to. Attorneys' fees, filing fees, and other legal

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163. *Dalston Const. Corp. v. Wallace*, 214 N.Y.S.2d 191, 193 (Dist. Ct. 1960).

164. Michael Pressman, *The Two-Contract Approach to Liquidated Damages: A New Framework for Exploring the Penalty Clause Debate*, 7 VA. L. & BUS. REV. 651, 656 (2013) ("[L]iquidated damages clauses are seen as enabling parties to control risk and increase predictability, and to create a remedy that is well tailored to the details specific to the parties and the agreement.").

165. Shiffrin, *supra* note 23, at 418 ("[E]nforceable remedial clauses may help parties avoid later negotiation and litigation costs."); Luca S. Marquard, *An Empirical Study of the Enforcement of Liquidated Damages Clauses in California and New York*, 94 S. CAL. L. REV. 637, 638 (2021) ("Parties typically include such clauses in their contracts in an attempt to minimize anticipated litigation time and cost and to avoid the unpredictability of courts' damages calculations.").

166. Paul Bennett Marrow, *The Unconscionability of a Liquidated Damage Clause: A Practical Application of Behavioral Decision Theory*, 22 PACE L. REV. 27, 33 (2001) ("A liquidated damage clause is, from the perspective of the draftsman, a default term; one that quantifies and assigns risk associated with a default by any party to a contract."); Jeffrey B. Coopersmith, Comment, *Refocusing Liquidated Damages Law for Real Estate Contracts: Returning to the Historical Roots of the Penalty Doctrine*, 39 EMORY L.J. 267, 283–84 (1990) ("A primary goal of such clauses is to control risk. The buyer is willing to stipulate damages so that he will be liable for no more than the agreed amount, while the seller is ensuring that the buyer will be liable for no less. Rather than roll the juridical dice, the parties to the contract are willing to pay a price for certainty." (footnotes omitted)).

167. Tess Wilkinson-Ryan & David A. Hoffman, *Breach Is for Suckers*, 63 VAND. L. REV. 1003, 1036–37 (2010) ("Autonomy theorists insist that such clauses—like all expressions of the parties' respective agreements—ought to be enforced to promote human flourishing.").

168. *See, e.g.*, *Brackelsberg v. Heflin*, 386 S.W.3d 636, 638 (Ark. Ct. App. 2011) (sellers retained earnest money deposit for more than a year after deal collapsed); *Aflalo v. Harris*, No. 05-21-01057-CV, 2023 WL 2522206, at *8 (Tex. App. Mar. 15, 2023) (noting that the parties had been in litigation for five years and the seller retained the deposit the entire time).

costs add up quickly in these sorts of disputes—and the parties can be embroiled in litigation for a very long time. An election clause also completely defeats the risk-allocation function of liquidated damages clauses. With a typical liquidated damages clause, both parties give up something to get something. A buyer, for instance, gives up the earnest money deposit even though there are no damages; in return, the buyer gets the certainty that he will not be obligated to pay more than that. When a liquidated damages clause is coupled with an election clause, there is no more risk allocation. Or, more accurately, the buyer assumes all the risk. Finally, the party autonomy rationale posits that "the contracting parties are best positioned to decide how to negotiate and resolve breaches of the terms and should be free to do so."[169] An election clause removes the parties' mutual agreement on damages and replaces it with the seller's unilateral control over its damages remedy after the fact.

A contract cannot meaningfully contain both a liquidated damages clause and an election clause. A liquidated damages clause is necessarily an exclusive remedy—*i.e.*, the liquidated damages amount represents what a breaching party *will* owe in the event of a breach. The presence of an election clause turns a liquidated damages clause on its head. An election clause is fundamentally incompatible with a liquidated damages clause and with the reasonable expectations of buyers in a real estate transaction.

V. IS SPECIFIC PERFORMANCE DIFFERENT?

Thus far, this Article has focused on the election between liquidated damages in the form of an earnest money deposit and actual damages. Is the situation any different if the seller preserves the right to pursue specific performance? The short answer is no.[170]

First, it should be noted that the doctrine of specific performance is an equitable remedy that is left to the sound discretion of the court.[171] Parties cannot "contract for" specific performance. A court must decide whether an award of specific performance is warranted on the facts of

169. Shiffrin, *supra* note 23, at 412.

170. The authorities seem to suggest yes. *See* Carey, *supra* note 27, at 25 ("The parties to a commercial real estate purchase contract may agree that liquidated damages will be the sole remedy of the seller for a breach of the buyer's obligation to purchase. But in the absence of such an agreement, a right to liquidated damages may not be an exclusive remedy for such a breach. In particular, the seller might have the alternative right to specifically enforce the contract.").

171. WHITMAN, BURKHART, FREYERMUTH & RULE, *supra* note 1, at 630 ("Both the vendor and purchaser are generally entitled to bring a suit in equity and obtain a decree of specific performance, compelling the other party to complete the contract.").

the case. Typically, a court will award specific performance if money damages are an inadequate remedy.[172] In the real estate context, specific performance almost invariably involves a court requiring a seller to convey title to property to a buyer, pursuant to the parties' agreement. The "performance" part of specific performance is the conveying of title. When a seller seeks specific performance, he would seek to have the buyer pay the purchase price in full and thereby take possession of, and title to, the property. The problem is that the "performance" here is predominantly the payment of money (the full purchase price). In this respect, because the seller is seeking the payment of the purchase price (money), it is hard to see how money damages are not an adequate remedy.[173] Thus, there is a double impediment at the outset: parties cannot contract for specific performance, and the facts do not support a court order of specific performance.[174]

Nonetheless, parties routinely include a clause which permits a seller to seek specific performance in their contracts for purchase and sale. Oftentimes, these clauses say that a seller has the right to choose between liquidated damages and other remedies available at law, including specific performance. When the election is between liquidated damages

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172. *DiMauro v. Martin*, 359 So. 3d 3, 9 (Fla. Dist. Ct. App. 2023) ("Specific performance is an appropriate remedy only when there is no adequate remedy specific at law, and a party that has an adequate remedy at law is not entitled to specific performance."); *EagleBank v. Schwartz*, No. 22-cv-01762, 2023 WL 6901964, at *12 (D. Colo. Aug. 18), *report and recommendation adopted*, No. 22-cv-01762, 2023 WL 6064596 (D. Colo. Sept. 18, 2023) ("Specific performance is an equitable remedy available only when there is no adequate remedy at law. 'The right to specific performance is not absolute. Whether the remedy should be granted depends upon the equities of the case and rests within the sound discretion of the trial court.'" (citations omitted) (quoting *Schreck v. T & C Sanderson Farms, Inc.*, 37 P.3d 510 (Colo. App. 2001))).

173. *See* Carey, *supra* note 27, at 25 ("Some members of our committee questioned whether specific performance would be available to a seller of real estate even in the absence of a liquidated damages clause. They argued that, while the buyer may be purchasing unique real property, the seller may be receiving only cash and in that event, a court of equity may refuse to award specific performance because damages are an adequate remedy.").

174. *Kesler v. Marshall*, 792 N.E.2d 893, 897 (Ind. Ct. App. 2003) ("In this case, the trial court concluded that Marshall was entitled to specific performance. However, none of the court's findings support the conclusion that monetary damages would be insufficient to fully compensate Marshall. Rather, Marshall could have kept Kesler's earnest money and terminated the contract, or resold the property and held Kesler liable for the difference between the actual sale price and the price under the contract. In either case, Marshall would have been fully compensated by damages for Kesler's failure to perform. Further, the traditional rationale underlying the grant of specific performance in real estate transactions, i.e., that each piece of property is unique, does not apply here to the party seeking specific performance, Marshall, because he is not obtaining the property in the transaction, but rather only money.").

and specific performance, the incompatibility problems are less facially apparent.[175] Since the choice appears to be one between money and performance (*i.e.*, actions), the inclusion of an election clause does not seem problematic.[176]

However, it is important to consider *what* the specific performance in this scenario entails: payment of the full purchase price. In any scenario where an aggrieved seller is seeking actual damages, the market price of the property has fallen after contract formation.[177] Accordingly, there is a money differential between the agreed-to contract price and the market value of the property on the date of the breach. For instance, assume a buyer agreed to purchase property for $500,000. The buyer breaches at a point where the fair market value of the property is only $475,000. If the seller sought actual damages, he would receive $25,000, the difference between the contract price and the fair market value at the time of breach. If the seller was awarded specific performance, he would get $500,000, which is $25,000 more than the property is worth on the open market. In short, specific performance in the form of full payment of the purchase price is the same as awarding actual damages. Indeed, the buyer would likely prefer to pay damages instead of the full contract price for a property he no longer can buy or wants to buy. Put in these terms, the election between liquidated damages and specific performance is no different than the election between liquidated damages and actual damages. One author observes that if a seller has a choice between an earnest money deposit and specific performance, "the concept of liquidated damages as a form of risk allocation is destroyed."[178] This is because the seller would always select the "more lucrative alternative."[179]

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175. WHITMAN, BURKHART, FREYERMUTH & RULE, *supra* note 1, at 629 ("If liquidated and actual damages seem obviously inconsistent, the same is not true of liquidated damages and specific performance.").

176. Indeed, a previous article of mine had not considered that the interplay between a liquidated damages clause and a clause providing for specific performance could be problematic. Monestier, *supra* note 18, at 1226 (proposing a carve-out for sellers electing specific performance).

177. Matthew Ingber, Comment, *Protecting the Benefit of a Seller's Bargain in Real Estate Contracts*, 30 TOURO L. REV. 761, 761 (2014) ("Courts measure damages for breach of a real estate contract based on the difference between the contract price and the fair market value of the property at the time of the breach, which seeks to protect the injured party's expectation interest." (footnotes omitted)); 3 E. ALLEN FARNSWORTH, FARNSWORTH ON CONTRACTS § 12.12 n.32 (3d ed. 2004) (stating that damages in real estate transactions are measured at the time of the breach); WILLISTON ON CONTRACTS, *supra* note 22, § 66:80 ("[T]he generally accepted measure of damages is the difference between the contract price and the fair market value of the property at the time of the breach.").

178. Coopersmith, *supra* note 166, at 302.

179. *Id.*

In concrete terms, the seller would elect specific performance in situations where "the difference between the contract price and the market price is greater than the liquidated sum."[180] As such, "economically, there is very little substantive difference between the remedies of specific performance and actual damages."[181]

Accordingly, courts should not permit seller election between remedies in the real estate context period, whether such election is between liquidated damages and actual damages or liquidated damages and specific performance.

VI. COMPOUNDING UNFAIRNESS

This Article has argued that election clauses are inherently unfair: The seller gets to have his cake and eat it too. He assumes no downside risk in a real estate transaction. The seller's worst-case scenario is receiving actual damages, and his best-case scenario is receiving a windfall.[182] Election clauses exacerbate the inherent lopsidedness in real estate transactions, where the seller tends to come out on top. Two elements of this pre-existing unfairness bear mentioning.

First, courts are very willing to enforce liquidated damages clauses in the real estate context.[183] They tend to rubber stamp such clauses without any meaningful scrutiny into whether such clauses actually constitute an unenforceable penalty.[184] So long as the percentage specified in the contract is within the range considered acceptable in that real estate market, a court will almost always enforce the clause.[185] All this means that a buyer has an uphill (and almost impossible) battle to challenge a liquidated damages clause in a purchase and sale agreement. So whatever amount of money a buyer chooses to put down as an earnest money deposit will almost certainly be forfeited. And oftentimes, that amount is a total windfall for the seller, whose losses do not come anywhere close to the tens or hundreds of thousands of dollars the buyer put down.[186]

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180. *Id.*

181. *Id.*

182. This oversimplifies the situation since the seller may incur non-compensable losses and would also need to outlay funds to recover actual damages.

183. Monestier, *supra* note 18, at 1170–71 ("Courts in the real estate context will, by and large, enforce liquidated damages clauses that require a buyer to forfeit his deposit. Unless the clause is unconscionable, or there is some other separate basis for non-enforcement, it is a fairly safe bet that a seller will be able to retain a buyer's deposit in a real estate transaction." (footnotes omitted)).

184. *Id.* at 1174–75.

185. *Id.* at 1175.

186. *See, e.g.*, *Karimi v. 401 N. Wabash Venture, LLC*, 952 N.E.2d 1278, 1282, 1288 (Ill. App. Ct. 2011) (holding that buyers forfeited a nearly $330,000 earnest

Second, buyers often have no meaningful remedies provided to them by contract.[187] In many cases, the contract for purchase and sale will limit the buyer's remedy to a return of the earnest money deposit.[188] However, the return of your own money (for a property that was not sold to you) is hardly a "remedy."[189] Contracts occasionally specify that a buyer may seek specific performance, which appears to level the playing field between buyers and sellers. However, the "right" to specific performance is often illusory. Buyers tend to be looking to buy a house *right now*—not in two or three years when a court issues an order for specific performance.[190] Add the cost of attorneys' fees[191] and pursuing specific performance becomes a very long-term and very expensive proposition.

Enter an election clause—where the buyer becomes a guarantor for the seller that they will assume no risk in a contractual transaction. As discussed, the election clause presents the cake-and-eat-it-too scenario that should trouble courts. But another part of the problem is that buyers will likely not realize that their contract contains an election clause until

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money deposit even though seller made an additional $400,000 on the resale of the property after the buyer's breach).

187. Debra Pogrund Stark, Jessica M. Choplin & Eileen Linnabery, *Dysfunctional Contracts and the Laws and Practices that Enable Them: An Empirical Analysis*, 46 IND. L. REV. 797, 798 (2013) ("We argue that these overly one-sided remedies clauses create 'dysfunctional contracts' because one party, the more sophisticated party (the seller/developer who drafted the form contract), can willfully default and terminate the contract with no harm to that party . . . . Since the main function of entering into a contract is for both parties to be bound through risk of exposure to negative consequences if they breach, these form contracts are dysfunctional because they remove all negative consequences for the sellers." (footnote omitted)).

188. *Id.* at 797.

189. *Id.* ("This is not a meaningful remedy because it does not cover any of the losses buyers would normally be entitled to under the law due to a breach of the contract, creating—as one court put it—'heads-I-win, tails-you-lose' illusory agreements.").

190. Margaret Heidenry, *When Can a Seller Back Out of a Home Sale? The 5 Times They May Bail*, REALTOR.COM (Mar. 7, 2023), https://www.realtor.com/advice/buy/can-sellers-back-out-of-a-home-sale/ [https://perma.cc/YX7N-PNNR] ("The problem with [pursuing specific performance] is it takes time and money for a buyer to enforce, and most home buyers don't want to wait a few years to get into a new home while their cash deposit sits in escrow. Most buyers would probably let it go . . . .").

191. Absent a clause in a contract, a buyer will have to pay his own attorneys' fees. *See* BRADLEY ARANT BOULT CUMMINGS LLP, *The American Rule Stands: Court Rejects Fee-Shifting Under Indemnity Clause*, JD SUPRA (Apr. 28, 2023), https://www.jdsupra.com/legalnews/the-american-rule-stands-court-rejects-7561288/ [https://perma.cc/SQ2J-CNXX] ("The 'American Rule' on attorneys' fees is that each party pays its own lawyers, even if you win.").

it is too late.[192] Many (if not most) buyers will assume that their liability is capped at the amount of the earnest money deposit. For instance, the buyer in *Avery v. Hughes* testified that he understood the non-refundable $25,000 earnest money deposit to represent his maximum financial exposure.[193] Many would-be breaching buyers believe that, at worst, they will lose their earnest money deposit if they do not go forward with the transaction.[194] This belief is reasonable for several reasons. First, it is common knowledge that you "lose" your deposit if you back out of a real estate contract;[195] it is not common knowledge that you might be on the hook for the seller's actual damages. Second, most purchase and sale agreements do not readily spell out the possibility that, by breaching, a buyer may be liable for far more than the earnest money deposit. Much of the language in these purchase and sale agreements appears intended to disguise the fact that the seller is permitted to have his cake and eat it too.[196]

A buyer may choose to breach a contract *because* he believes the deposit will be all he owes. In other words, a buyer may view the

192. *See* Meirav Furth-Matzkin & Roseanna Sommers, *Consumer Psychology and the Problem of Fine-Print Fraud*, 72 STAN. L. REV. 503, 508 (2020) ("Few consumers will notice at the time of signing that they have been misled about the terms of a transaction; many will realize this only after the fact when they are hit with a nasty surprise.").

193. Defendant's Memorandum of Law in Opposition to Plaintiff's Motion for Partial Summary Judgment, at 4, *Avery v. Hughes*, No. 09-CV-00265 (D.N.H. Oct. 19, 2010), *aff'd*, 661 F.3d. 690 (1st Cir. 2011), 2010 WL 11425928, at *4 ("When the parties negotiated the Agreement, Hughes intended that the $25,000 deposit would be non-refundable and would serve as the liquidated damages specified in the Agreement. Hughes understood that $25,000 was his maximum exposure when he entered into the Agreement. Hughes understood at that time that Avery was willing to accept that." (citations omitted)). The Court did not doubt the veracity of these claims. It simply stated that the buyer's own personal interpretation or understanding of the contract did not matter. *Avery*, 661 F.3d at 694.

194. *Margaret H. Wayne Tr. v. Lipsky*, 846 P.2d 904, 906 (Idaho 1993) ("On October 19, the stock market began a precipitous decline which caused [buyer] to reconsider his decision to invest in a vacation home. Sometime in late October, he called [seller] and informed him that he did not intend to close the purchase and would forfeit the earnest money he had paid . . . ."). Of course, a prospective breacher could consult an attorney. But many attorneys probably do not realize that a number of courts enforce election clauses.

195. *What Is Earnest Money & How Much Should You Pay*, CHASE, https://www.chase.com/personal/mortgage/education/financing-a-home/understanding-earnest-money#:~:text=There%20are%20times%20when%20homebuyers,the%20house%20is%20beyond%20repair [https://perma.cc/4PNH-YL2Q] (noting "popular belief" that homeowners "always forfeit their earnest money to the seller if a deal fails").

196. Oftentimes the deposit provision and the election of remedies provisions are separate and need to be read in conjunction with one another. Only one case I looked at clearly spelled out the seller's right to actual damages (though it is unlikely a buyer would understand the provision's meaning).

liquidated damages clause in the contract as an option to not perform and simply forfeit the designated amount. Behavioral decision theory supports this proposition. Professor Wilkinson-Ryan concludes that there is a "positive relationship between the presence of a liquidated-damages clause in a contract and parties' willingness to breach a contract."[197] Otherwise stated, "when the penalty for breach is formally included in the agreement between the parties . . . parties are more likely to choose to breach."[198]

Here, the situation is a little different in that the contract in question is arguably ambiguous about the consequences of breach (*i.e.*, it does contain an election clause alongside a liquidated damages clause). Nonetheless, if the buyer *believes* that he will owe the liquidated amount[199]—and only the liquidated amount—in the event of breach, then that might affect the decision to breach at first instance. All of this to say that buyers might inadvertently fall victim to an election clause, choosing to breach because of a miscalculation that their liability will be capped at the amount of the earnest money deposit.

Once the buyer has breached, the mere presence of an election clause will create pernicious spillover effects, whether or not that clause is enforceable.[200] Consider the factual posture in which these cases arise. An earnest money deposit is made at the time the purchase and sale agreement is signed. It is usually held in escrow by an agent of the seller.[201] If a buyer breaches the purchase and sale agreement, the seller will have all the financial leverage. The seller is already holding on to what is usually a very sizeable deposit,[202] plus he can lord the possibility of "actual damages" over the buyer's head.[203] Even if there are no

197. Wilkinson-Ryan, *supra* note 111, at 636.

198. *Id.*

199. Tess Wilkinson-Ryan, *Justifying Bad Deals*, 169 U. PA. L. REV. 193, 196 (2020) ("The literature suggests that people defer to the terms as written, even when the assent is perfunctory, and even when a term is unfair.").

200. *See* Furth-Matzkin & Sommers, *supra* note 192, at 508 (noting that laypeople "assume that they are stuck with what they signed"). *See also* Meirav Furth-Matzkin, *The Harmful Effects of Unenforceable Contract Terms: Experimental Evidence*, 70 ALA. L. REV. 1031, 1055 (2019) (concluding that unenforceable terms in residential lease contract was "detrimental to tenants" as they "adversely affect[ed] [tenants'] behavior and decisions"); Daniel Wilf-Townsend, *Deterring Unenforceable Terms*, 111 VA. L. REV. (forthcoming 2025) (arguing that the law should penalize drafters for including clearly unenforceable terms in their contracts).

201. Monestier, *supra* note 18, at 1158.

202. *Parker v. Knauf*, No. CV085007670, 2010 WL 1375564, at *4–7 (Conn. Super. Ct. Mar. 3, 2010) (finding valid a liquidated damages clause where deposit was ten percent of the purchase price—equal to $290,100).

203. This is true even in jurisdictions that will not enforce election clauses. *See, e.g.*, Sullivan, *supra* note 141, at 1136 ("[T]he obvious reason why one party would seek

damages and the earnest money amounts to a penalty, a buyer will be unlikely to challenge it for fear of "what if?": "What if I end up somehow paying more than the deposit?" In this respect, buyers are encouraged to cut their losses even though they may have a good claim that a deposit constitutes an unlawful penalty.

Moreover, a seller may use the threat of actual damages to coerce a settlement from the buyer in an amount somewhere between the deposit amount and the claimed damages. Buyers will be risk averse[204] and will weigh the potential of a huge damages award plus attorneys' fees[205] into the calculus. They may "blame *themselves* for failing to read at the time of signing," leaving them "disinclined to renegotiate with sellers."[206] This means buyers will be adversely affected, one way or another, by a provision that should not have been in the contract to begin with.[207]

VII. WHAT IS MOTIVATING COURTS?

Several courts,[208] attorneys,[209] and authors[210] have recognized the fundamental incompatibility of a liquidated damages clause and an election clause. Indeed, the authors of a leading property law treatise write, "One might expect the recovery of actual damages to be foreclosed almost automatically by the presence of a liquidated damage clause; after

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a clause it knew to be unenforceable is that it believed the other party to be unaware of the fact and likely to remain unaware of it. This might be because the second party lacks sophistication and legal counsel. Further, at least in some contexts the insisting party might reinforce the clause's implicit message that it is enforceable as written.").

204. Hillman, *supra* note 144, at 724 ("People prefer certainty over ambiguity and make choices to avoid uncertainty. They choose certain results over gambles, even when the latter are superior based on the law of probability." (footnotes omitted)).

205. Attorneys' fees may include their own and possibly their counterparty's.

206. Furth-Matzkin & Sommers, *supra* note 192, at 510. This observation was made in the context of consumer fraud cases, but it is equally applicable in the real estate scenario.

207. *See* Sullivan, *supra* note 141, at 1128–29 ("Contracts frequently contain clauses that are not enforceable—at least, not enforceable as written. . . . [I]t seems certain that invalid terms continue to be used by those who are well aware that they are unenforceable as written, presumably because they have utility for those who impose them. The most obvious reason is that the other party to the contract (or, conceivably, some third party) either does not realize the clause is unenforceable as written or is not willing to risk the resources needed to establish its invalidity." (footnotes omitted)).

208. *Lefemine v. Baron*, 573 So. 2d 326, 329–30 (Fla. 1991); *Grossinger Motorcorp, Inc. v. Am. Nat'l. Bank & Tr. Co.*, 607 N.E.2d 1337, 1346 (Ill. App. Ct. 1992).

209. Carey, *supra* note 27, at 24 (expressing surprise that election clauses are enforceable).

210. WHITMAN, BURKHART, FREYERMUTH & RULE, *supra* note 1, at 629 ("[L]iquidated and actual damages seem obviously inconsistent.").

all, the evident purpose of the [liquidated damages] clause is to fix the vendor's damages recovery at the agreed amount."[211] So why is it that many courts are failing to recognize that liquidated damages clauses and election clauses do not mix?

The explanatory forces might be different depending on whether the court is upholding the liquidated damages clause or the election clause. In the liquidated damages scenario, courts might be influenced by the general perception that if you breach a contract, you should forfeit your deposit—full stop. The presence of an election clause, which the seller is not relying on, should not get in the way of this recovery. The subtext is that the breaching party cannot rely on a technicality after the fact to get out of a deal that he clearly struck. To the extent that someone should get a windfall, it should not be the breaching party.

The calculus may be a little different for courts that uphold an election clause in the face of a liquidated damages clause. It appears that some courts genuinely think that the two clauses are compatible—that a liquidated damages clause is simply one option in the menu of remedies that the parties agreed to.[212] Courts strangely seem to believe that they are bound by the parties' choice in this regard.

Interestingly, however, many courts find ways to avoid awarding a seller damages pursuant to an election clause. Thus, even though courts do not object to awarding actual damages in theory, they are loath to award them in practice. Usually, courts will rely on the doctrine of election of remedies[213] to conclude that a seller is relegated to the liquidated damages amount. If a seller does not return the earnest money deposit to the buyer prior to filing suit, courts will almost invariably conclude that the seller has elected to retain the earnest money deposit and is foreclosed from pursing actual damages.[214]

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211. *Id.* at 628.

212. *Avery v. Hughes*, 661 F.3d 690, 696 (1st Cir. 2011).

213. 28A C.J.S. *Election of Remedies or Rights or Theories of Recovery* § 1 (2019) ("Election of remedies is the choice by a party to an action of one of two or more coexisting remedies or rights or theories of recovery, arising out of the same facts. In some jurisdictions, the rule is disfavored, is applied in a strict and limited way, or is inapplicable.").

214. *See, e.g.*, *Mountain Courtyard Suites v. Wysong*, 452 F. Supp. 3d 1275, 1281–82 (D. Utah 2020) ("[Seller's] failure to release the earnest money before filing suit bars its suit to the extent it seeks 'general damages' or any remedy other than the earnest money, even though the earnest money is held by an escrow agent and [seller] cannot unilaterally retain it as liquidated damages."). But note that the parties' contract could draft around this problem. *See, e.g.*, *Sagatov Builders LLC v. Hunt*, 88 Va. Cir. 410, 410 (2014) ("The relevant provision of the Contract provides: If the Purchaser is in default, the Seller shall have all legal and equitable remedies, *retaining the Deposit until such time as those damages are ascertained,* or the Seller may elect to terminate the contract and declare the Deposit forfeited as liquidated damages and not as a

For instance, in *Osborn v. Dennison*,[215] sellers of a residential property brought an action seeking actual damages after the buyer failed to close on the transaction.[216] The court did not see any issues with the presence of an election clause in the purchase and sale agreement.[217] However, it found that the seller had elected to retain the earnest money deposit and was therefore foreclosed from trying to establish actual damages.[218] The court reasoned that the seller may seek damages, but "may not tie up the buyer's earnest money" while doing so.[219] As such, the seller must direct the release of the earnest money to the buyer prior to or at the same time as filing suit.[220] The court noted that if a seller could hold onto the earnest money deposit while seeking actual damages, this would "cause uncertainty as to how long this advantage could continue," "create imbalance between the parties," and "undermine the purpose of the default provision of the Residential Offer to Purchase."[221] What is most interesting about the court's reasoning is the concern about fairness in the mechanics of election. The court was more concerned with the unfairness of a seller retaining an earnest money deposit after filing suit than it was with the unfairness of a buyer having to potentially pay actual damages even though the buyer believed he would only have to forfeit his earnest money deposit. The concern seems misplaced. To the extent that courts are worried about "uncertainty" and "imbalance," it should be in the context of sellers attempting by contract to do something they should not be able to do.

Additionally, the irony in many of the cases dealing with the timing and mechanics of election is unmistakable. Courts are almost uniformly insistent that a seller must "elect" between the earnest money deposit in their possession and the right to pursue actual damages; thus, the seller must return the earnest money deposit prior to filing suit.[222] Sellers cannot have it both ways. But a seller is permitted to have it both ways

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penalty . . . . If the Seller does not elect to accept the Deposit as liquidated damages, the Deposit may not be the limit of the Purchaser's liability in the event of a default." (emphasis added)).

215. 768 N.W.2d 20 (Wis. 2009).

216. *Id.* at 22–23.

217. *Id.* at 30.

218. *Id.* at 30–31.

219. *Id.* at 30.

220. *Id.*

221. *Id.* at 30–31.

222. There are a few cases, however, where courts appear unconcerned with whether the seller returned the earnest money deposit prior to filing suit. *See, e.g.*, *Aflalo v. Harris*, No. 05-21-01057-CV, 2023 WL 2522206, at *7 (Tex. App. Mar. 15, 2023) (concluding that a seller's failure to return earnest money before suing buyer did not constitute election of liquidated damages as a remedy).

when it comes to conceptual choice between liquidated damages and actual damages. In other words, a seller may agree to two inconsistent remedies in the contract but may not act inconsistently in choosing between those two remedies.

Phillips v. Gomez is another example of a case where the court seemed to bend over backward to limit the seller to the earnest money deposit—but not in the most plausible way (*i.e.*, by finding the election clause invalid).[223] In *Phillips*, the seller sought actual damages of approximately $133,000, with a credit of $66,000 (reduced by $4,000 in commission fees) from the earnest money being applied to the total amount.[224] The court noted that "Idaho is one of several states that have upheld provisions allowing sellers to choose between liquidated and actual damages."[225] In theory, therefore, the seller would have been permitted to pursue a claim for actual damages. However, the parties had amended the purchase and sale agreement at some point to provide that the earnest money deposit was "non-refundable."[226] The court held that the non-refundability provision amounted to an advance election on the part of the seller to accept the deposit as liquidated damages: "[A] plain reading of the agreement indicates that Phillips pre-elected his remedy for Gomez's breach of the contract."[227] The court took issue with the seller "trying to expand the limited right of retention into a right to keep the deposit and apply it to whatever larger damages he can establish."[228] The court appeared not to realize that, functionally, it was countenancing the very thing it objected to: retaining a deposit and then topping it up with actual damages.[229] Whether the seller returns the deposit and then seeks $136,000 or whether the seller keeps the deposit and seeks $70,000, the buyer ends up in the same position—owing actual damages.

The court's reasoning seems like a very circuitous route to the right result: to limit the seller to actual damages. But the result should not have turned on the parties' choice of one word—"non-refundable."[230] Instead,

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223. 405 P.3d 588, 596 (Idaho 2017).

224. *Id.* at 590–91.

225. *Id.* at 593.

226. *Id.*

227. *Id.*

228. *Id.* at 811.

229. In *Avery v. Hughes*, the court allowed the seller to elect actual damages even though the purchase and sale agreement contained similar "non-refundable" language. 661 F.3d 690, 694 (1st Cir. 2011). In that case, the non-refundability provision apparently did not evidence the seller's intention to pre-elect liquidated damages.

230. *Phillips*, 405 P.3d at 594 ("However, when the parties amended RE-21, thereby making the earnest money non-refundable and immediately transferable to Phillips, Phillips pre-elected the earnest money as liquidated damages, regardless of what Phillips subjectively intended.").

the result should have been preordained because of the incompatibility of a liquidated damages clause and an election clause. That courts are bending over backward to limit sellers' recovery to liquidated damages says something about the propriety of allowing the election of actual damages to begin with.

VIII. THE WAY FORWARD

What should courts do when an election clause accompanies a liquidated damages clause in a purchase and sale agreement? The easiest solution in this respect is for state legislatures to prevent election clauses from being beneficial to the seller. In previous work, I proposed a deposit statute aimed at regulating the amount of earnest money that buyers should reasonably have to forfeit in a real estate transaction.[231] As part of the deposit statute, I suggested the following language dealing with election clauses: "A clause which purports to allow the seller the right to elect to pursue monetary remedies in lieu of, or in addition to, liquidated damages shall relegate the seller to actual damages or the liquidated damages deposit, *whichever is lower*."[232] Recognizing that there may not be legislative will in this regard, the task will fall on courts to right the ship. The solution, however, cannot be to wholesale declare election clauses unenforceable because that would only deal with one of the two scenarios described above (*i.e.*, where a seller is looking to elect actual damages in lieu of liquidated damages). It would not help with the scenario where a buyer attempts to argue that the presence of an election clause renders the liquidated damages clause a penalty.

Accordingly, courts must deal with election clauses in the specific context in which they arise. Where a seller is seeking to retain an earnest money deposit in a contract that also contains an election clause, courts should find that the liquidated damages clause is a penalty as a matter of law.[233] The fact that the contract included an election clause evidences the seller's intent to penalize the buyer by providing a guaranteed minimum of damages in the event of a breach.

On the other hand, where a seller is seeking to elect actual damages pursuant to an election clause, courts should declare the election clause invalid and relegate the seller to the liquidated damages amount. A liquidated damages clause and election clause are fundamentally incompatible. The seller's attempt to have both should be met with a declaration that the election clause is unenforceable.

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231. Monestier, *supra* note 18, at 1225–27.

232. *Id.* at 1226–27 (emphasis added).

233. *See Lefemine v. Baron*, 573 So. 2d 326, 330 (Fla. 1991).

This doctrinal solution replicates the statutory proposal outlined above. Essentially a seller is stuck with the lesser of the two measures of damages he has attempted to arrogate to himself. This solution leaves a seller free to contract for either liquidated damages or actual damages but not both at the same time.

CONCLUSION

Cake-and-eat-it-too clauses are a trap for the unwary. Most buyers understand that if they default on an agreement of purchase and sale, they may forfeit their earnest money deposit. What they do not realize is that the deposit may be just the beginning—they could owe tens or hundreds of thousands of dollars on top of that. Sure, buyers could read the fine print in the contract, which would alert them to the possibility that upon breach, the seller could retain the earnest money *or* "proceed at law." But, without a law degree, a buyer could be forgiven for not having any clue what that means.

Courts need to get over the "you signed it, you're bound by it" mentality which seems to pervade so many of these cases. Just because you signed something does not always mean you are bound by it; that is why contract law exists. The inconsistency between liquidated damages clauses and election clauses is patent. If a seller attempts to include both clauses in a contract, courts should enforce the less favorable clause. Where a seller wants to retain the deposit pursuant to a liquidated damages clause, and the contract contains an election clause, a court should invalidate the liquidated damages clause and relegate the seller to proving actual damages. Where a seller wants to pursue actual damages under an election clause, a court should strike the election clause and limit the seller to the earnest money deposit.

This issue will continue to bubble to the surface in coming years. With dramatic shifts in the real estate market, and the sums at stake becoming larger and larger, sellers will continue to push boundaries until courts finally stop them.