

# LIQUIDATED DAMAGES IN HAWAII REAL ESTATE PURCHASE AND SALE AGREEMENTS



**RAYMOND S. IWAMOTO** is a transactional lawyer of Schlack Ito, LLLC, who handles complex real estate and business transactions. He is a Fellow of the prestigious American College of Real Estate Lawyers and served a three year term on its Board of Governors. He is listed in the Best Lawyers in America, Chambers USA America's Leading Lawyers for Business, Superlawyers, and the International Who's Who of Real Estate Lawyers. He was listed in the 14th Edition of Who's Who Legal: Real Estate 2017 as one of the leading real estate practitioners in the United States. He represents local, national and international developers, land owners, financial institutions and individuals engaging in diverse real estate and business acquisitions, development and real estate financing in Hawaii. He has been engaged as an expert witness in real estate litigation. Mr. Iwamoto was born and raised in Honolulu, Hawaii, and graduated from McKinley High School. He is a former U.S. Army Captain, Medical Service Corps., a Vietnam war veteran and a former State Judge Advocate General for the Hawaii Army National Guard.

This article is not intended to provide legal advice. The views expressed (which may vary depending on the context) are not necessarily those of the author, Schlack Ito or ACREL or the Acquisitions Committee. Any errors are those of the author.

---

Members of the Acquisitions Committee of the American College of Real Estate Lawyers are examining certain questions regarding the topic of "liquidated damages" in their respective jurisdictions. The focus is on commercial real estate contracts and the enforceability of liquidated damage clauses (LDC) in commercial real estate contracts that provide that, in the event of default by the Buyer, the Seller is entitled to retain a liquidated damage amount (LDA), usually the deposit, as liquidated damages. The Hawaii appellate courts have not yet provided answers to many of these questions. These questions are:

1. May the seller choose specific performance instead of liquidated damages (so that liquidated damages are not an exclusive remedy)?
2. May the seller choose actual damages instead of liquidated damages (so that liquidated damages are not an exclusive *damage* remedy)?
3. If the seller may choose liquidated damages or actual damages, may it have both?
4. If the seller may choose liquidated damages or actual damages, but not both, when must it decide?

5. Is there an applicable statute addressing liquidated damages clauses?
6. What is the test for a valid liquidated damages clause?
7. Who has the burden of proof?
8. As of when is "reasonableness" tested?
9. What percentage of the purchase price is likely acceptable as liquidated damages?
10. Are actual damages relevant for liquidated damages and, in particular, will liquidated damages be allowed when there are no actual damages?
11. Is mitigation relevant for liquidated damages?
12. Is a "Shotgun" liquidated damages clause enforceable?
13. Does a liquidated damages clause preclude recovery of attorneys' fees by the seller?

## **1. May the seller choose specific performance instead of liquidated damages (so that liquidated damages are not an exclusive remedy)?**

The case law in Hawaii has not addressed whether a Seller may have an option to choose either liquidated damages or specific performance. The Hawaii

courts have not addressed whether specific performance is a remedy that is available to a Seller.

## **2. May the seller choose actual damages instead of liquidated damages (so that liquidated damages are not an exclusive damage remedy)?**

The case law in Hawaii has not addressed whether a Seller may have an option to choose either liquidated damages or actual damages. It may be that so long as the contract did not provide for the LDC to be the exclusive remedy (or even if it did), a Seller may plead alternative remedies such as liquidated damages, actual damages and/or specific performance but, at some point before trial, has to elect one of the alternative remedies. See answer to question 4.

## **3. If the seller may choose liquidated damages or actual damages, may it have both?**

There is no case specifically addressing whether a Seller may elect between liquidated damages or actual damages or whether it may have both. However, in *Dias v. Vanek*, 67 Haw. 114, 679 P.2d 133 (1984) (“Dias”), the Hawaii Supreme Court cites Hawaii cases on liquidated damages and the principle of reasonable relationship to actual damages, but then goes on to cite cases that hold that the determination of damages is the exclusive province of the jury and orders a retrial because this jury had already been discharged. The opinion says there is nothing in the record to clarify the question of retention or return of the down payment of \$20,000 and the damages for breach in the amount of \$6,263. *Dias*, 67 Haw. at 118, 679 P.2d at 136. The Court could have ruled that the Seller should refund the amount of the liquidated amount in excess of the actual damages amount, i.e., \$20,000 minus \$6,263 or at least some refund. So, we are left to wonder if it’s up to the jury to say that or to say that the Seller can retain the \$20,000 liquidated amount and the Buyer still has to pay the actual damages amount of \$6,263. We have found no other case law that comes any closer in addressing the question whether a Seller may choose between actual damages and either

an optional or exclusive LDC or whether the Seller could obtain judgment for both.

In *Gomez v. Pagaduan*, 1 Haw. App. 70, 613 P.2d 658 (1980) (“Gomez”), an issue was whether the Seller could retain the liquidated damages payment and obtain a judgment for the rental value of the property after the agreement was cancelled. The judgment for rental in addition to the payments made was affirmed without any discussion of the fact that the liquidated damages clause at issue said that the payments made may be retained as liquidated damages *and rent*.

In *Kona Hawaiian Associates v. Pacific Group*, 680 F. Supp. 1438 (D. Haw. 1988) (“Kona”), a federal district court was faced with an argument that Gomez stood for the proposition that where the amount of the liquidated damages is too low, the provision will not be deemed exclusive. The Court rejected this argument by saying that it was clear in Gomez that the additional damages awarded were not the loss of bargain but for the rental value and were not damages suffered by reason of the Buyer’s failure to close. As a federal district court case, this ruling is not binding on the Hawaii state courts.

A recent arbitration involved an LDC. In the arbitration, the Seller demanded the LDA but reserved the right to demand a higher amount if the actual damages were sufficiently in excess of the LDA. Seller’s theory was that this meant that the LDA was not a reasonable estimate of actual damages and that therefore actual damages should take precedence. Also, \$800,000 of the \$1,000,000 deposit had previously been released from escrow and paid to the Seller, and the Buyer argued that the \$800,000 should be credited against the \$1 million LDA. However, the arbitrator awarded the Seller \$1,000,000, ruling that the \$800,000 paid was consideration for an extension of time to close. The arbitrator further ruled that in light of actual damages of \$19.7 million, \$1,000,000 would not be a forfeiture and, citing *Shanghai Inv. Co., Inc. v. Alteka Co., Ltd.*, 92 Hawai’i 482, 993 P.2d 516 (2000) (“Shanghai”), discussed *infra*, ruled that the LDC was enforceable.

In its Order confirming the Arbitration award in *Young Men’s Christian Association of Honolulu v. Aloha Kai Development, LLC* (“YMCA”), Civ. No. 18-00086 ACK-KSC, 2018 U.S. Dist. LEXIS 94289, (D. Haw. June 5, 2018), the Federal Court ruled that the arbitrator’s interpretation of the contract was plausible and within his authority and confirmed the award of damages in the amount of \$1,000,000. Then the Court, citing *OWBR LLC v. Clear Channel Communications, Inc.*, 266 F. Supp. 2d 1214 (D. Haw. 2003), ruled that the Seller had to establish that its actual damages were reasonably related to the amount of liquidated damages it was entitled to recover and cited *Shanghai* for the proposition that liquidated damages must be enforced if there is a reasonable relation between the LDA and the amount of actual damages. *YMCA*, 2018 U.S. Dist. LEXIS 94289, at \*22. Since the YMCA claimed actual damages in the amount of \$19.7 million, the \$1,000,000 award did not constitute a penalty. The Court then said that the reason the LDA had to have a reasonable relation to the actual damages is because otherwise LDCs would be unenforceable if it functions as a penalty or forfeiture. *Id.*

#### **4. If the seller may choose liquidated damages or actual damages, but not both, when must it decide?**

Once again there is no case law guidance, but in litigation practice, it appears that the trial judge would require the Seller to elect at some point to elect one of the alternative remedies that the Seller had included in his pleadings. If the LDC permits either the LDA or actual damages or is silent as to whether the LDC is the exclusive remedy and if actual damages exceeded the LDA, there would be no incentive for the Seller to choose the LDC as its remedy.

#### **5. Is there an applicable statute addressing liquidated damages clauses?**

Hawaii does not have a statute that addresses liquidated damages in transactions involving real estate. However, in connection with the sale of goods, Article 2 of the Uniform Commercial Code (UCC) addresses LDC.

Hawai’i Revised Statutes (HRS) section 490:2-718 provides that damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy.

The UCC provides that its purpose is to clarify the law concerning commercial transactions and therefore addresses liquidated damages in such transactions. HRS § 490:1-103. Thus, a Hawaii court may find the UCC informative in addressing commercial real estate transactions. In *Association of Apartment Owners v. Walker-Moody Constr. Co., Ltd.*, 2 Haw. App. 285, 630 P.2d 652 (1981) (“Walker-Moody”), the Hawaii Intermediate Court of Appeals (the “ICA”) said that it preferred to take a consistent and enlightened approach by applying the UCC rule even though the case is not specifically under its coverage. See also *Am. Elec. Co., LLC v. Parsons RCI, Inc.*, 90 F. Supp. 3d 1079, 1084 (D. Haw. 2015) (“Am. Elec.”), discussed below.

#### **6. What is the test for a valid liquidated damages clause?**

*Gomez* was the first appellate case to address enforceability of an LDC. *Gomez* stated that the decision in *Jenkins v. Wise*, 58 Haw. 592, 574 P.2d 1337 (1978) (“*Jenkins*”) compels its decision and went on to hold that where the Buyer’s breach did not involve bad faith conduct, an LDC clause would be enforced by the Seller if there was a reasonable relationship between the amount of payments retained and the amount of Seller’s actual damages. *Gomez*, 1 Haw. App. at 75, 613 P.2d at 661-62. *Gomez* was followed by *Shanghai*. In *Shanghai*, the Hawaii Supreme Court mentioned that the jury found no bad faith breach and stated that under *Gomez*, the Seller was entitled to retain the deposit if it bore a reasonable relationship to actual damages. *Shanghai*, 92 Hawai’i at 494-95, 993 P.2d at 528-29. See also *Kaiman Realty, Inc. v. Carmichael*, 65 Haw. 637, 655 P.2d 872 (1982) (“*Kaiman*”); *Dias*, 67 Haw. 114, 679 P.2d 133.

Jenkins was an LDC case only in the sense that the Seller wanted to cancel the agreement and keep the LDA deposit. Since the Court held for the Buyer and ordered specific performance in favor of the Buyer, the enforceability of the LDC was no longer at issue. When the LDC is at issue in a case, we only know what the law is if the Buyer's breach does not involve bad faith.

Thus, case law in Hawaii for the enforceability of an LDC has only addressed situations where the Buyer's breach does not involve gross negligence or bad faith. In Jenkins, the market value had appreciated and the case was about a non-bad faith defaulting Buyer's rights to specific performance. In Gomez, the market value had depreciated and the litigation was over the LDC. Yet the ICA said that the Jenkins principle applies to the Gomez situation. Gomez, 1 Haw. App. at 75, 613 P.2d at 661-62. Gomez then established the law in Hawaii for the enforceability of an LDC where the Buyer's breach does not involve bad faith.

Jenkins was a jury waived case and the trial judge found that the Buyer defaulted the agreement of sale by failing to pay interest and principal when due, and that this warranted cancellation of the agreement. Jenkins, 58 Haw. at 595, 574 P.2d at 1340. However, there were other facts involved that influenced the finding of no bad faith. There is no Hawaii case law to assist us in determining when a Buyer's breach involves bad faith or even to tell us whether the LDC is enforceable where the Buyer's breach does involve bad faith. Even if facts reveal that the Buyer was grossly negligent in failing to close or somehow acted in bad faith in failing to close or refusing to close, it may be that a Seller should still be able to enforce the LDC provided the reasonable relationship test is met. We are also left to wonder if the Buyer's breach did involve bad faith that the Seller could still enforce the LDC even if the reasonable relationship test was not met. Other than dicta in Gomez we have no case authority for the enforceability of an LDC where the Buyer's breach was in bad faith. Gomez suggests that the Seller may be entitled to forfeiture if there had been a bad faith breach. Speaking about the Seller, the ICA said, "He

is not, absent purchaser's bad faith, entitled to forfeiture." Gomez, 1 Haw. App. at 75, 613 P.2d at 661-62.

We can say that Hawaii law leaves it to the discretion of the trial judge to answer these uncertainties. In Scotella v. Osgood, 4 Haw. App. 20, 659 P.2d 73 (1983) ("Scotella"), the Buyer's failure to close when required was due to delays by an appraiser and it is likely the Court thought that this breach did not involve bad faith. So, the ICA remanded the case to the trial court to determine the issue of bad faith and whether the Sellers could be adequately compensated for any injury and whether a forfeiture would result, if specific performance was denied. Id. at 25-26, 659 P.2d at 76-77.

In doing so, it stated that the trial court, in exercising its discretion, and applying the reasonable relationship test, could uphold cancellation of the agreement while ordering a refund of that portion of any moneys paid which would constitute a penalty rather than reasonable liquidated damages. Id.

Several of the cases cited in this Article involve installment land sale contract cases, called "agreements of sale" where typically possession and "equitable interests" are transferred to the buyer at an initial closing followed by a subsequent title conveyance closing when the balance owed under the agreement of sale is paid. These include Jenkins, Kaiman, Dias and Gomez. In agreement of sale cases, the Hawaii courts will note that they are akin to financing instruments and that forfeitures include not only the payments made by the buyer but forfeiture of the right of possession and the equitable interest. Other cases cited involve executory contracts where possession as well as title would not yet have passed. These include Shanghai, Scotella and Kona. Despite the different considerations between installment land sale contracts and the ordinary executory contracts, this difference has not been a factor in the cited cases.

## **7. Who has the burden of proof?**

In Hawaii, the party attempting to enforce the liquidated damages clause has the burden of proof to introduce evidence that the LDA bore a reasonable

relationship to actual damages. Customarily, the Seller has to put on testimony regarding its actual damages and, as the party enforcing the liquidated damages clause, has the burden of proof of establishing the reasonable relationship between the deposits and the Seller's actual damages.

In *Shanghai*, the Court noted that, although the Seller had a full and fair opportunity at trial to adduce evidence that the \$5 million in damages bore a reasonable relationship to its actual damages, it did not do so. *Shanghai*, 92 Hawai'i at 495, 993 P.2d at 529.

One wonders if a Seller elects actual damages instead of the LDA under an LDC, the Buyer might raise the LDC as a defense and possibly could have the burden of proof in trying to enforce the LDC.

### **8. As of when is "reasonableness" tested?**

Note that the UCC permits reasonableness to be tested either at the contracting stage or after damages have been incurred.

The UCC's "consistent and enlightened" approach recognizes that there may be difficulties of proof of loss and thus permits a liquidated damages amount that is reasonable in the light of the anticipated harm. HRS § 490:2-718. Thus, the UCC contemplates a prospective look to compare the LDA with anticipated damages.

From the available case law, in the *Gomez* situation it would appear that under Hawaii law, the reasonableness requirement is to be determined as of trial and a court would not enforce the LDC based purely on a prospective view and would require a retroactive look in testing whether the liquidated damages clause is reasonable and enforceable. Where there are actual damages, the prospective test would appear to be moot because even if it appeared reasonable or unreasonable at the time of contracting, the retrospective look at the actual damages would probably be determinative. However, the following federal cases that apply Hawaii law discusses when reasonableness is to be tested, i.e., both the prospective and retrospective tests. Since Hawaii case law is sparse on the enforceability of LDC, these

federal court opinions could be used to argue that it is possible under Hawaii law and under the right circumstances that either test could be used to determine enforceability of a liquidated damages clause.

*Clear Channel* was a Hawaii federal district court case that was not a purchase and sale case. In that case, the defendant cancelled a hotel conference due to the September 11, 2001 World Trade Center terrorist attacks. 266 F. Supp. 2d at 1216. Instead of a fixed liquidated damages amount, there was a cancellation fee based on a schedule. *Id.* at 1225. The Court stated correctly that under Hawaii law, liquidated damages must be enforced if there is a reasonable relation between the liquidated damages and the amount of the party's actual damages and that a clause that constituted a penalty would not be enforced. *Id.* at 1226.

However, the Court also turned to the Restatement (Second) of Contracts § 356 and found that two factors determined whether there was a penalty. The first factor is the reasonableness of the amount in light of the anticipated or actual loss. (Both prospective and retrospective tests.) The second factor is difficulty of proof of loss. The Court stated that the Plaintiff's difficulty in proving its loss weighs in favor of a finding that the liquidated damages clause is enforceable. *Id.*

This case was a motion for summary judgment case, and due to conflicting evidence of the amount of anticipated and actual damages, the Court determined that there was a genuine issue of material fact and denied the Plaintiff's motion for summary judgment as to the issue of damages with respect to the actual loss part of the first factor of the Restatement (the retrospective reasonableness factor). *Id.* at 1227. But the Court also granted the Plaintiff's Motion for Summary Judgment as to the issue of damages with respect to the second prong (difficulty of proof of loss). *Id.* at 1226-27, 1229. This partial denial and partial granting of summary judgment is subject to interpretation. Was satisfying one of the tests sufficient and was this an order for summary judgment upholding the LDC or, since summary judgment on the reasonableness test was denied, did it mean

that there would have to be a trial on that issue. The next federal district court case further discusses this issue.

Am. Elec. was a construction delay case providing for liquidated damages for delay. It is instructive in that it provides that even if the parties used the required “buzz” words for the test on a prospective basis, the Court said it will not be divested of its ability to review the reasonableness and enforceability of the clause and the use of terminology such as penalty or liquidated is not determinative. Am. Elec., 90 F. Supp. 3d at 1084. Then the Court actually addressed the question as to whether, under Hawaii law, the test was a prospective or retrospective test or both and even cited to Article 2 of the Uniform Commercial Code. The Court determined that the retrospective actual damages test was only a preferred test and that the Hawaii courts did not foreclose the use of anticipated damages, noting that the prospective test was the majority rule in the United States. *Id.* at 1088. The Court declared that it would apply both prospective and retrospective tests. *Id.* at 1089. This prospective test was pertinent in this case because it appeared that there may not have been actual damages as a result of the construction delay but that it was reasonable to have anticipated that there would be. Nevertheless, since this was a Motion for Summary Judgment, the ultimate holding was that there were genuine disputes of material fact precluding summary judgment.

So, if this federal judge accurately described Hawaii law, if the amount of liquidated damages was reasonable at the time of contracting, and if Hawaii law did not “foreclose” the prospective test, and the comparison to actual damages is only a “preferred” test, then it may be that given the right case, a non-defaulting party could recover liquidated damages based on a prospective test even if no actual damages resulted. On the other hand, in a purchase and sale case, if there has been market appreciation and the Seller is retaining a property with a value in excess of the purchase price yet seeks to keep the Buyer’s deposits as liquidated damages, it would appear unlikely that a court would enforce the LDC, no matter what the majority rule is in this Country.

Both Clear Channel and Am. Elec. are federal district court cases where proof of actual damages was problematic. As federal district court cases, their interpretation of Hawaii law is not binding. For purposes of this article, which focuses on real estate purchase and sale cases, difficulty in measuring actual damages would be rare as expert testimony could establish fair market value for comparison to the price and the LDA. In all likelihood, if these federal district court cases were to be interpreted that under Hawaii law it would be sufficient to satisfy only the prospective test when actual damages was difficult to determine, they would still not be good precedent for real estate purchase and sale cases. In those cases, the retrospective test looks to be the test to be used. So, even if the LDA is deemed to be a reasonable estimate of anticipated harm, if proven later to be disproportionate to actual damages, the LDC might not be enforced.

Perhaps the parties can contract around the uncertainty as to whether the prospective test alone can determine the enforceability of the LDC. The following is a clause where the second section addresses the prospective/retrospective issue:

The parties agree that, if the Buyer breaches the Contract by failing to perform its obligations by the deadline specified (as the same may be extended as provided herein), the Seller’s damages will be difficult to calculate or measure with precision. The parties have made a good faith effort at arriving at a reasonable forecast of the Seller’s probable actual damages and have considered the likely impact of any default by Buyer and the various types of damages likely to be incurred. As a result, the parties have agreed on the amount of the Deposit as liquidated damages. The intention of the parties is to approximate the potential actual damages and this sum is not intended as a penalty. In other words, the parties have not agreed on this sum as a disincentive to prevent a breach of contract but instead as a good faith estimate of the actual damages that the Seller is likely to suffer.

The parties further agree, that the market is complex and that the Seller has complex commitments that

will be impacted by any default by Buyer and in consideration of all of this, they have agreed on liquidated damages in order to have an efficient remedy in the event of such default without the necessity of having to provide evidence of actual damages or to attempt to prove actual damages and to avoid disputes about direct damages, consequential damages and other such issues. The parties have agreed that the amount of the Deposit bears a reasonable relationship to the parties' reasonable estimate at this time of the damages the Seller is likely to suffer in the event of Buyer's breach and that this reasonableness is to be tested as of the date that the parties enter into this agreement and have agreed that to simplify procedures and to save costs, there is no requirement to examine the actual consequences of any default.

### **9. What percentage of the purchase price is likely acceptable as liquidated damages?**

In real estate purchase and sale transactions, typically at the time of contracting, the LDA is the amount of the deposit with the Seller having the right to keep the deposit as liquidated damages in the event of the Buyer's default. Deposits are usually a small enough percentage of the purchase price to appear to be reasonable. So in a prospective test, the amount could pass muster. However, for the retrospective test, actual damages would typically depend on whether the market price had appreciated or declined.

The following is from a trial level case and illustrates the retrospective test. This was for the sale of several resort condominium units where the deposits totaled \$497,000. The actual damages, a 17 percent drop in market price, plus remarketing expenses and commission added up to \$515,450. The Judge ruled that \$497,000 bore a reasonable relationship to \$515,450 and ruled that the Seller was entitled to keep the deposits as liquidated damages.

Since the determination of "reasonable relationship" is left to the discretion of the trial judge, there will always be a question as to whether you can have a reasonable relationship if the deposits had exceeded

the actual damages and whether in the judgment of the trial judge the excess amount would still have a reasonable relationship to the actual damages.

Buyers will expend considerable funds in conducting due diligence and will not agree to limit its remedies in the event of Seller default to termination of the contract. So, the contract will typically provide that Buyers will have all remedies available in law or in equity, including specific performance as well as damages. At times, the parties will cap the damages by agreeing for Seller to pay Buyer's costs subject to a ceiling. There may be contracts where the cap is described as a liquidated damages amount. While there is no case law in Hawaii on such a provision in favor of the Buyer, the same principles will probably apply. The amount might have to bear a reasonable relationship to the Buyer's actual damages.

### **10. Are actual damages relevant for liquidated damages and, in particular, will liquidated damages be allowed when there are no actual damages?**

Gomez reviewed Jenkins and case law in other jurisdictions and adopted the requirement that there be a reasonable relationship between the LDA and actual damages. 1 Haw. App. at 73-75, 613 P.2d at 661-62. The test of reasonable relationship to actual damages requires evidence of actual damages or loss. The Court in Shanghai ruled that the trial court erred in allowing the Seller to retain a five million dollar deposit as liquidated damages because of lack of evidence of actual damages. 92 Hawai'i at 495, 993 P.2d at 529. The record in Shanghai did not disclose the fair market value of the property, the actual or estimated costs of resale and other costs, and the Seller failed to present any substantial evidence that the \$5 million earnest money deposit bore any relationship to the actual loss. Accordingly, the Court ruled that the trial court erred in allowing the Seller to retain the entire \$5 million deposit as liquidated damages.

Whether an LDA bears a reasonable relationship to the amount of actual damages is left to the discretion of the trial judge. An LDA that exceeds actual

damages could be enforceable if still viewed as having a reasonable relationship or unenforceable if viewed as a penalty. This leaves open the question as to whether a Hawaii court would enforce an LDC with an LDA couched as a minimum or even as a range of amounts. Would that allow for an award over the minimum or within the range if the amount of actual damages was such that a trial judge can decide that an LDA over the minimum or within the range bears the requisite reasonable relationship?

Therefore, under these cases, liquidated damages will not be allowed when there are no actual damages or when the Seller fails to produce evidence of actual damages. However, as described in section 8 above, since it is not clear under Hawaii law that reasonableness has to be tested only after there are actual damages, if the court were to test reasonableness only against anticipated damages at the time of contracting, liquidated damages could be allowed when there are no actual damages.

### **11. Is mitigation relevant for liquidated damages?**

Since the test in Hawaii under Gomez is to determine the reasonableness of the liquidated damages versus actual damages, actual damages are affected by the need to mitigate. In Hawaii, as elsewhere, the aggrieved party (the Seller) has a duty to make every reasonable effort to mitigate his damages. While not an active mitigation action, in Clear Channel there is a discussion of post default revenues received by the Seller which were to be used to offset and calculate the Seller's actual damages. 266 F. Supp. 2d at 1228-29.

In Hawaii, failure to mitigate damages is a defense and the burden would be on the Buyer to prove that mitigation is possible. *Malani v. Clapp*, 56 Haw. 507, 542 P.2d 1265 (1975). In purchase and sale transactions, the obvious mitigation would be to resell the property. There are two potential problems here. First, the resale price may not accurately reflect the value of the property, and second, if the parties are litigating the enforceability of the Seller's rights to keep the deposit, theoretically the Seller's ability to

market the property is constrained by the litigation and the Buyer's continuing rights under the contract and mitigation through resale may not be possible until the litigation with the Buyer is concluded.

### **12. Is a "shotgun" liquidated damages clause enforceable?**

To have an LDC for any default of any covenant does not appear to be customary in real property purchase and sale agreements, and we have found no Hawaii appellate decision on whether such an LDC would be enforceable.

### **13. Does a liquidated damages clause preclude recovery of attorneys' fees by the seller?**

In cases where the liquidated damages clause is upheld, under Gomez, it would be upheld because the Court thought the amount had a reasonable relationship to the actual damages and that conceivably the Seller's actual damages would have included his out-of-pocket expenditures such as for legal fees. This probably will depend on the liquidated damages clause in question. It may state that it is the exclusive remedy for all the Seller's damages and this would then include legal fees or it may state that it is the exclusive remedy except for attorney's fees. In Gomez, the LDC simply stated that in the event of the purchaser's default, the Sellers may elect to cancel the agreement and all payments theretofore made shall be retained by the Seller and shall be deemed to be liquidated damages and rent for the use and occupation of the property and in settlement of any depreciation of the same and not as a penalty. In footnote 2, the ICA said that the trial court may, if authorized by law, award attorney's fees and costs which were not included in the calculation of actual damages. Gomez, 1 Haw. App. at 76 n.2, 613 P.2d at 662 n.2. Hawaii law authorizes the award of attorney's fees in cases concerning assumpsit damages which is defined as for the recovery of damages for non-performance of a contract. *Schulz v. Honsador, Inc.*, 67 Haw. 433, 690 P.2d 279 (1984).

Then too the trial court might consider the type of attorney's fees involved. Attorney's fees incurred in mitigation efforts could be considered part of



actual damages but attorney's fees incurred in enforcing the defaulted contract might be considered part of actual damages or might be considered as separate damages.

## CONCLUSION

Hawaii case law on liquidated damages is nowhere settled and there are a lot of uncertainties. What we can conclude is that the enforceability of an LDC is left to the discretion of the trial court and if, in its opinion, the amount of the liquidated damages is a penalty, the clause will be unenforceable. It will be enforceable if there is no bad faith breach and if, in the trial court's opinion, the LDA bears a reasonable relationship to the actual damage. The retrospective test and determination of actual damages appear to be required but the prospective test may be applicable in a given case. One wonders whether an LDC is even needed and whether in a contract that provides for a non-refundable deposit, a Seller may plead alternative remedies such as specific performance, actual damages or retention of the deposit and then elect the remedy of retention of the deposit without the necessity of proving the enforceability of a LDC.

As transactional lawyers, we have customarily taken tips from case law throughout the nation in drafting what we would consider required provisions for the liquidated damages clause. These would include statements of anticipated difficulty of measuring actual damages, no intent to penalize, and other such "buzz" words. Sometimes we would negotiate statements of "exclusive remedy". Such drafting and negotiating of the liquidated damages clause is based on anticipating the need to satisfy a prospective test. A federal magistrate reminds us that our efforts may not be as important as we think and that the language used will not prevent the Court from reviewing the enforceability of the clause from a retrospective view and the use of particular words will not be determinative. *Am. Elec.*, 90 F. Supp. 3d at 1084. Furthermore, since, based on the uncertainty created by *Dias*, it may be possible that given the right circumstances, Hawaii law might permit the award of both liquidated and actual damages,

or whichever is higher or allow the Seller to have a choice and furthermore, since the trial court will take a retrospective look at the case and apply its discretion, it may be prudent to avoid providing that the liquidated damages clause is the exclusive remedy in lieu of actual damages. All of this creates more negotiating issues as a Buyer's perspective is certainly different. Finally, as noted above, it may be sufficient to provide for a nonrefundable deposit in lieu of an LDC. But until there is more certainty in the case law, Sellers will probably still insist on a liquidated damages clause. 🍷