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Remedies in Real Estate Transactions, Part 1: Liquidated Damages
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Real estate is a unique asset and therefore damages resulting from a breach of an agreement are often difficult to measure. As a result, parties need to give give careful thought to the remedies for a breach. In this four-part series, Adrienne Koch and Neil Miller will examine some of the remedies that should factor into that analysis, starting with liquidated damages.

It is a catechism of New York law that, because real estate is a unique asset, damages resulting from a breach of an agreement involving it are often difficult to measure. As a result, parties to such agreements must give careful thought to the remedies for such breach. This four-part series will examine some of the remedies that should factor into that analysis, starting with liquidated damages.

A Brief Primer

Provisions for liquidated damages—that is, a pre-determined amount of compensation that a party who fails to perform must pay—are common in many kinds of real estate transactions. They obviate the need to calculate (and potentially litigate over) damages and settle the parties' expectations by operating as both a floor and a ceiling on potential liability. And because a liquidated damages provision is negotiated at the outset of the transaction (before either party knows whether or how it will be triggered), it likely represents the parties' unvarnished view of what is fair.

Such provisions, however, are often subject to later challenges. Courts will not enforce them if the amount of liquidated damages is seen as disproportionate to any damage actually incurred, or if the parties knew or should have known when they entered the contract that actual damages would be readily ascertainable.

In other words, liquidated damages provisions must keep to their own lane: they are enforceable only when they are truly designed to compensate for damages that would otherwise be difficult or impossible to calculate, and then only when they represent a reasonable approximation of such damages. Parties who wish to include such a provision in their agreement need to be mindful of these litigation concerns in drafting the provision.

Moreover, courts look beyond the language of the contract in determining whether a particular provision should be analyzed under the rubric of liquidated damages. Sometimes a liquidated damages provision is obvious. For example, agreements for the purchase and sale of real estate almost always provide that if the purchaser defaults the seller may retain the purchaser's deposit.

This is generally considered an appropriate use of liquidated damages because the seller's actual damages—which could include lost opportunities to sell the property to someone else; a need to cover financing obligations that would have terminated with the sale; or any number of other consequences—are difficult to anticipate or quantify at the time of the contract. But other liquidated damages provisions may be less obvious. For example:

• **Fee reduction:** Construction agreements often provide that if the project is not completed by a particular date, the contractor's fee will be reduced by a certain amount per day thereafter. That fee reduction might not be called "liquidated damages," but that is exactly what it is. It addresses a concern that a construction delay may impact the owner's ability to use, sell, lease, or finance the subject property—with significant financial consequences. Rather than attempt to quantify these damages, the parties agree to "liquidate" them through the daily fee reduction.

• **Rent abatement:** A commercial lease for premises that are not yet fully constructed may provide that if the premises are not completed by a specified date the tenant will be entitled to free or reduced rent for a period calculated based on the length of the delay. This rent abatement—which addresses a concern that the tenant's inability to begin using the premises at the anticipated time may have consequences that are difficult to measure—amounts to liquidated damages, regardless of what the lease calls it.

• **Late fees:** Late fees in leases or financing agreements are also a species of liquidated damages. Delays in making payments under such agreements may cause the payee difficulties in meeting its own obligations; the late fee—regardless of whether it is called "liquidated damages"—is designed to compensate for those difficulties, which are otherwise difficult to measure.

What these various scenarios have in common is that at the outset of the transaction the parties agree that certain conduct will have a specific economic consequence, in the form of either a payment to one party or a reduction in the amount owed to the other. Such an agreement is considered a liquidated damages provision regardless of what the parties choose to call it, and will be analyzed as such if it is later challenged.

Drafting Lessons

What does this mean for parties who wish to include such a provision in their agreement? Care in drafting will increase the likelihood that a provision will be enforced according to its terms. A series of cases involving rent abatements illustrates this point.

In *Bates Advertising USA, Inc. v. 498 Seventh, LLC*, 7 N.Y.3d 115 (2006), the Court of Appeals enforced a lease provision that gave the tenant a rent abatement if the landlord was late in completing certain improvements. It held that the abatement—which was "keyed to the number of days" of delay and "varied from a half day to a day [of free rent] depending upon the importance of the item of work not completed"—was "not grossly out of scale with [the tenant's]

foreseeable losses" arising from construction delays that impacted the quality of the premises (which the tenant occupied as its "700-person worldwide headquarters"). 7 N.Y.3d at 117, 120.

The court reasoned that "[b]y imposing [a] one-to-one proportionality between the days the breach continued and the value of the compensation, the parties successfully avoided the possibility that the tenant would obtain a benefit in gross disproportion to the injury it suffered," and that any "disproportions were as likely to inure to the benefit of the landlord as to that of the tenant." 7 N.Y.3d at 119 (citations and internal quotations omitted; alteration in *Bates*).

This reasoning has been applied to uphold a rent abatement as large as two days for each day of construction delay, where the delay prevented the tenant from taking possession and the actual damages arising from that delay would be difficult to ascertain. *Duane Reade v. Stonybrook Realty LLC*, 63 A.D.3d 433, 434 (1st Dept. 2009) (abatement "compensated the tenant, which was to operate in a new geographical market, for damages flowing from delays in delivering possession that were not readily ascertainable when the parties executed the lease" and "were not unreasonably disproportionate to foreseeable losses"); see 2008 WL 5948831, *13 (appellant's brief, describing details of abatement).

On the other hand, where actual damages can be ascertained, a rent credit that is "grossly disproportionate" to such damages may be found unenforceable. *Free People of PA LLC v. Delshah 60 Ninth, LLC*, 169 A.D.3d 622, 623 (1st Dept. 2019) (declining to enforce rent credit provision that would have given the tenant a "windfall" substantially greater than the $650,000 of actual damages awarded); see 2018 WL 7501590, *9-10 (respondent's brief, making clear that the provision would have given the tenant as many as three days of free rent for each day of delay). And if the rent abatement is disproportionately small in relation to actual damages—and does not clearly specify that it takes the place of such damages—it may be enforced in addition to a claim for such damages. See *APW, Inc. v. Marx Realty & Improvement Co., Inc.*, 291 A.D.2d 333, 334 (1st Dept. 2002).

The broader lessons are these. The first inquiry for parties crafting a liquidated damages provision should be to ensure they have a reasonable basis for claiming that actual damages would be difficult to ascertain, such as where the project relates to a new business (as in *Duane Reade*) or a core function/location (as in *Bates*). They should also make sure that neither side is overreaching with respect to the amount: if the amount is too high or too low, courts will be more likely to try to find a way around the provision, either by declining to enforce it entirely (as in *Free People*) or by finding that it does not take the place of actual damages (as in *APW*).

Careful drafting will also include consideration of the possibility of pro-rating the liquidated damages, different measures of liquidated damages for different types of breaches, and the method and timeline for payment. It is also important to specify what kinds of breaches are subject to liquidated damages, whether such damages are an exclusive remedy, and whether any exceptions apply, as well as to ensure that other provisions in the contract do not conflict with the liquidated damages clause.

Conclusion

When properly used, liquidated damage provisions allow parties in real estate transactions to avoid costly disputes over the calculation of actual damages and offer the comfort of certainty. As with most remedial provisions, however, they work best when they are drafted with an eye toward how they will fare if they are actually triggered.

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