

When a buyer and a seller executed a valid contract for the sale of a house, the buyer gave the seller \$1,000 as earnest money. The contract noted that the earnest money tendered would be applied to the purchase price at the time of sale but was silent as to remedies in the event of any default.

Just before the closing, the buyer lost her job. The buyer told the seller that she could no longer purchase the house and asked him to return the earnest money. The seller accurately told the buyer that the seller's actual losses exceeded the amount of the earnest money; that if the seller sued the buyer for damages, he would receive a minimum of \$5,000; and that it would be difficult for him to sell the house in the current market.

Should the buyer get the earnest money back?

- A. No, because the contract was silent regarding remedies.
- B. No, because the seller's actual losses exceeded the amount of the earnest money.
- C. Yes, because the buyer is no longer ready, willing, and able to purchase the house.
- D. Yes, because the reason for the buyer's default was not anticipated.

Explanation:

Seller's remedies

Rescission & restitution	Rescind (ie, cancel) agreement & recover possession of property Rental value & physical damages are recoverable Buyer not liable for purchase price
Specific performance	Seek an injunction ordering buyer to pay agreed purchase price May be unavailable if money damages provide adequate compensation & property is not unique eg, condominium identical to other units in complex
Damages	Loss of bargain = contract price – market value at time of breach Liquidated damages = amount designated in the sales contract as compensation for breach Retain buyer's deposit (up to amount of seller's actual damages) Incidental & consequential damages that were contemplated during sales contract or reasonably foreseeable

Earnest money is a deposit paid by a buyer to show a good-faith intent to complete the transaction. Once accepted, the seller cannot recover other damages for breach. That is because earnest money typically **constitutes liquidated damages**—ie, an amount **agreed upon** during **good-faith** negotiations **to reasonably compensate** the injured party. These damages are **recoverable unless** they constitute a **penalty** (eg, when liquidated damages far exceed actual damages). In such a case, the seller can only recover actual damages.

Here, the buyer gave the seller \$1,000 as earnest money. The contract was silent as to remedies, so the \$1,000 constitutes liquidated damages (**Choice A**). The buyer breached the contract when she reported that she could no longer purchase the house, causing the seller to sustain losses. Since those actual losses *exceed* the amount of the earnest money, the liquidated damages provision is likely enforceable. As a result, the seller should receive the full \$1,000 and the buyer should not receive any earnest money back.

(Choice C) The seller is entitled to the \$1,000 because the buyer is no longer ready, willing, and able to purchase the house. This fact would not allow the buyer to get the earnest money back.

(Choice D) Unless otherwise stated, liquidated damages will be paid to the injured party as compensation for any breach, regardless of whether the breach was anticipated.

Educational objective:

Earnest money typically constitutes liquidated damages, which are generally recoverable upon the buyer's breach. But if liquidated damages are deemed a penalty (eg, when they far exceed actual damages), then the seller may recover only actual damages.

References

22 Am. Jur. 2d Damages § 540 (2020) (earnest deposit considered liquidated damages).

77 Am. Jur. 2d Vendor and Purchaser § 478 (2020) (seller's recovery of liquidated damages).

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