**Q.  I went under contract to purchase a piece of property.  In connection with the contract, I paid $25,000 in earnest money.  Due to changing circumstances, however, I cannot move forward with the deal.  Is there any way for me to get my earnest money back?**

A. For starters, the buyer is always entitled to a return of earnest money if the contract expressly allows it in the context of a contingency or inspection period. Short of an express contractual right to a return of the earnest money, the question becomes whether the earnest money is a valid form of damages for the buyer’s failure to close. This question was recently answered by the Fulton County Superior Court in a case our firm litigated successfully for the buyer.  The short answer is that, in most standard form contracts, such as the Georgia Association of Realtors (“GAR”) form real estate contract, a provision allowing the seller to recover earnest money as liquidated damages is probably not enforceable.

Let’s address the easy route to a return of the earnest money first: the contract.  In many cases, the contract expressly allows for a return of the earnest money to the buyer upon the failure of certain contingencies.  One of the most common examples is a financing contingency.  For example, if the closing is contingent on the buyer obtaining financing, and the buyer cannot obtain financing, the buyer can seek a return of the earnest money by following the steps in the contract after failing to obtain financing.

If there are no contingencies (or if they have all expired), the next question is whether the provisions in the contract entitling the seller to the earnest money are valid “liquidated damages” provisions.

A “liquidated damages” provision is a contract clause whereby the buyer and seller agree at the time of contract what the damages for a breach of the contract will be. Typically, under Georgia law, the damages owed by a buyer for failing to close on a real estate contract are the difference in the contract price and the value of the land at the time the buyer failed to close.  So if the contract price was $450,000, and the land was worth $400,000 at the time the buyer failed to close, the seller is entitled to damages of $50,000.  But again, the buyer and seller can set liquidated damages so that there is no need to prove actual damages if buyer fails to close.

In order to be enforceable, however, a liquidated damages clause must not constitute a penalty and must satisfy a stringent test under Georgia law: (1) the damages must be difficult or impossible to estimate; (2) the parties must have intended to provide for liquidated damages; and (3) the liquidated damages must be a reasonable pre-estimate of the actual damages.  In addition, the liquidated damages must be both the minimum and maximum damages for the breach.  In other words, the seller cannot have the *option* to *either* sue for actual damages (the difference in the contract price and the fair market value at the time of breach) *or* take the liquidated damages, whichever is better for the seller.

In the Fulton County Superior Court, we argued successfully that the GAR form contract did not contain a valid liquidated damages clause because, among other reasons, the form contract gave the seller the option to seek either actual damages or the earnest money as liquidated damages.  As a result, the Georgia Association of Realtors has undertaken to change its form contract to make it more compatible with Georgia’s test for liquidated damages.

The lesson is this: buyers and sellers should take care to understand the requirements and implications of a liquidated damages provision.  If the seller wants a valid provision, it should consult a lawyer to make sure all of the liquidated damages boxes are checked.  Simply relying on a form contract will not establish a valid liquidated damages clause. In addition, it is important to keep in mind what the *actual damages* may be, as seller might be unnecessarily capping its relief. For example, if the market value of the property at the time of the breach by the buyer is $50,000 less than the contract price, the seller’s actual damages are $50,000. A liquidated damages provision providing for the forfeiture of $10,000 in earnest money would therefore not adequately compensate the seller for buyer’s breach.