

# DYSFUNCTIONAL CONTRACTS AND THE LAWS AND PRACTICES THAT ENABLE THEM: AN EMPIRICAL ANALYSIS

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## INTRODUCTION

A review of purchase agreement forms used by condominium developers in Chicago, Illinois from 2003-2008 (the “Condo Contracts Study”<sup>1</sup>) discovered that 79% contained highly unfair, one-sided remedies clauses. Specifically, as detailed in Part I, these forms provided that the buyer’s sole remedy in the event of the seller’s breach was the return of the buyer’s own earnest money.<sup>2</sup> 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.<sup>3</sup> In essence, these clauses constitute a waiver of the right to recover benefits of the bargain/expectation damages, consequential damages, reliance-type damages, and

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1. The Condo Contracts Study was based on a Freedom of Information Act (“FOIA”) request by Professor Stark of the City of Chicago to view all of the property reports filed by developers of condominiums in Chicago, Illinois during 2003-2008 (attached as one of the exhibits to each property report was a form purchase and sale contract for the condominium units that the developer planned to use). Boxes of such filed property reports were made available to Debra Stark’s research assistants, and approximately twenty-five property reports (one report is issued for each condo building) were randomly selected to review for each of those years for a total of 155 form purchase contracts from a base of 631 property reports. Debra Pogrund Stark et al., *Condo Contracts Study: Chicago, Illinois 2003-2008*, which were accessed in 2009-2010 (on file with author) [hereinafter *Condo Contracts Study*]. A detailed analysis of some of the other contracts clauses reviewed under this study will appear in a future article.

2. *See* *Condo Contracts Study*, *supra* note 1.

3. *Blue Lakes Apts., Ltd. v. George Gowing, Inc.*, 464 So. 2d 705, 709 (Fla. Dist. Ct. App. 1985).

the remedy of specific performance. Further compounding the unfairness of this limited remedy clause is the fact that these same form contracts also provide the seller with the ability to recover substantial damages in the event of the buyer's breach. Typically, the contracts provided that for the buyer's breach of the contract the seller could retain the buyer's deposit (usually an amount between 5-10% of the purchase price).<sup>4</sup> 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.<sup>5</sup> Hence, the contract provides no true binding agreement from that party. Meanwhile, under these contracts, the other party is bound and would suffer a material harm if she failed to perform. 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. Indeed, such contracts could be construed as invalid and lacking in consideration because one of the party's promises are illusory, a conclusion drawn by some courts in Florida, but one that courts in other jurisdictions have rejected.<sup>6</sup> Courts in jurisdictions outside of Florida have refused to strike down this type of liability limiting clause under the unconscionability test due to the "clear" wording of these "bargained for" clauses.<sup>7</sup>

But do laypersons really comprehend these clauses that appear to lawyers and judges as clearly limiting liability? And if not, how does this impact, first, the premise that the laypersons bargained for this result when they signed the purchase agreement and, second, the application of the unconscionability test for striking down a limitation of liability clause? This Article discusses a "Remedies Experiment"<sup>8</sup> the authors ran which attempts to assess the layperson's comprehension of the highly unfair limitation-of-remedy clauses found in so

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4. See Condo Contracts Study, *supra* note 1; *Blue Lakes Apts., Ltd.*, 464 So. 2d at 709.

5. Terminating the contract and returning the purchaser's earnest money is technically a legal consequence of rescission and partial restitution, but it does not provide the buyer with a recovery for the buyer's losses caused by the seller's breach, nor does it impose a loss on the seller for terminating the contract or create a disincentive to engage in strategic defaults.

6. Compare *Port Largo Club, Inc. v. Warren*, 476 So. 2d 1330, 1333 (Fla. Dist. Ct. App. 1985) (finding that limiting the purchaser's damages to the return of his deposit "render[ed] the seller's obligation wholly illusory and would permit him to breach with impunity") and *Blue Lakes Apts., Ltd.*, 464 So. 2d at 709 (finding such clauses render the seller's obligations to be illusory), with *Tanglewood Land Co. v. Byrd*, 256 S.E.2d 270, 271 (N.C. Ct. App. 1979) (applying Virginia law, the court held that if a seller fails to perform under a contract, the buyer may "sue for specific performance or breach of contract," but unless it can be shown the seller acted in bad faith, the fact that the seller's only obligation would be to refund the buyer's payment does not render the contract illusory).

7. See *infra* Part III.

8. Debra Pogrud Stark et al., *Consumer Remedies*, Chicago, Illinois (2010-2011) (on file with the author) [hereinafter *Remedies Experiment*]. See *infra* Part II.B.

many real estate developer form contracts. We found that the results from our experiment reflect a widespread failure of the participants to understand the impact of this type of clause on their rights after a breach. These results undercut the premise upon which the unconscionability test rests: that the home purchaser understood the clearly worded limitation clause and therefore bargained for this result.<sup>9</sup> Thus, while many courts refuse to strike down these clauses under the unconscionability test, this Article argues that the results from the Remedies Experiment should lead courts to adopt a different set of tests for ruling on the enforceability of limitation-of-remedy clauses in home purchase contracts.

Part I of this Article highlights the relevant results from two empirical studies Professor Stark conducted regarding major problems with the fairness of purchase agreement forms used by residential real estate developers in Illinois. Part I also discusses the lack of home purchaser understanding of key relevant laws and legal documents examined in an empirical study conducted by Professor Michael Braunstein in Columbus, Ohio.<sup>10</sup> Part II of this Article contains a detailed report of the results from the Remedies Experiment we ran.<sup>11</sup> This experiment demonstrated that, contrary to the assumption of many judges, even after carefully reviewing limitation-of-remedies clauses, a very large percentage of laypersons believed they were entitled to remedies that were “clearly” (at least to an attorney or judge’s eyes) excluded in the contract clause. In Part III, the Article examines and critiques case law on the enforceability of these limitation-of-remedies clauses noting the split of authority among the reported case law in the United States on this issue and why Florida’s approach of providing greater protection to home purchasers is more appropriate. In Part IV, the Article proposes four legal reforms to address the problem of dysfunctional contracts that contain highly unfair and problematic remedies clauses.

#### I. HIGHLIGHTS FROM TWO EMPIRICAL STUDIES IN ILLINOIS AND AN EMPIRICAL STUDY IN COLUMBUS, OHIO

As previously noted, a key finding from Professor Stark’s Chicago Condo Contracts Study was that 79% of the form contracts reviewed contained terms that provided no remedy to the condo purchaser to cover the purchaser’s losses due to the seller’s breach or to deter the seller from strategic, willful defaults.<sup>12</sup> At the same time, however, the seller/developer retained valuable remedies upon default of the buyer’s contractual obligations.<sup>13</sup> The form contracts overwhelmingly contained a clause limiting the buyer’s sole and exclusive remedy in the event of the seller’s breach to termination of the contract and

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9. *Tanglewood Land Co.*, 256 S.E.2d at 271 (determining the contract was supported by consideration).

10. Michael Braunstein & Hazel Genn, *Odd Man Out: Preliminary Findings Concerning the Diminishing Role of Lawyers in the Home-Buying Process*, 52 OHIO ST. L.J. 469, 476-79 (1991).

11. See Remedies Experiment, *supra* note 8.

12. See Condo Contracts Study, *supra* note 1.

13. *Id.*

return of the buyer's own earnest money (an obligation that would exist regardless of the contract clause identifying it as the buyer's sole remedy<sup>14</sup>). This creates a waiver of other more meaningful remedies to address the seller's breach, such as specific performance, benefit of the bargain, reliance, or consequential damages, without explicitly setting forth these rights and saying these rights are now waived. Only 4% of the sampled form contracts' remedies clauses permitted the buyer to seek compensatory/bargain type remedies available under the law in the event of the seller's default had the contract been silent on the issue of remedies.<sup>15</sup> In the same form contracts, sellers were granted the compensatory remedy of liquidated damages (in the form of retention of the buyer's earnest money—typically under those contracts at somewhere between 5-10% of the purchase-price amount) in 68% of the contracts and were permitted all available remedies in the event of the buyer's default in 23% of the contracts.<sup>16</sup>

Equally important to any limitation-of-remedies clause is how the contract treats attorneys' fees for enforcing the agreement. Unless the contract provides for attorneys' fees for the prevailing party, few buyers could afford to bring a lawsuit to challenge the validity of a limitation-of-remedy clause because the attorneys' fees are likely to be substantial, sometimes even exceeding their damages claims.<sup>17</sup> According to the Condo Contracts Study, only 14% of the contracts contained a provision entitling the prevailing party in a lawsuit relating to a purchase contract to attorneys' fees.<sup>18</sup> Therefore, in 86% of these form contracts, the purchaser is far less able to bring a claim for specific performance or damages and to challenge any applicable limitation-of-remedy clause when the seller has breached the contract.<sup>19</sup>

A survey of over one hundred attorneys in Illinois conducted by Stark ("Attorney Survey") also reflects the serious problems with remedies clauses in condo purchase agreements found in the Condo Contracts Study.<sup>20</sup> In the

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14. *Id.* Generally, when a buyer deposits a sum of money with the seller, or with a third party, it is with the express intent that it be used to pay a portion of the purchase price if the deal is closed and serve as security if the buyer defaults. In fact, if the deal does not close due to the seller's default or other reasons not the fault of the buyer, then the seller is obligated to repay that amount of money to the buyer. *See Kopis v. Savage*, 498 N.E.2d 1266, 1269-72 (Ind. Ct. App. 1986).

15. Condo Contracts Study, *supra* note 1.

16. *Id.*

17. According to one source, fees associated with litigating a lawsuit range from 30-60% of the total recovery. *See* JEFFREY O'CONNELL, THE LAWSUIT LOTTERY: ONLY THE LAWYERS WIN 86 (1979). When the claim involves a construction defect, experts are likely to be necessary, adding to the typical costs of litigation.

18. *See* Condo Contracts Study, *supra* note 1.

19. *Id.* If the contract is silent on the recovery of attorneys' fees for a suit based on the contract, the prevailing party is not entitled to an award of its attorney's fees unless there is an applicable statute to the contrary. *See infra* note 81.

20. Debra Poggrund Stark, Illinois Real Estate Attorney Survey (circulated in 2010) (on file

Attorney Survey, when asked in an open-ended question what terms in the condo purchase contracts they have seen that were highly unfair or highly problematic, 51% referred to the limitation-of-liability to the seller or the limitation-of-remedies to the buyer as their chief concern.<sup>21</sup> When asked to rate their level of satisfaction with various terms in the condo purchase contracts they have seen, in response to the remedies available to the buyer, 32% of surveyed attorneys rated their level of satisfaction as “1” (with “1” being the lowest level of satisfaction and “7” being the highest), another 22% rated it with a “2,” 15% rated it with a “3,” leaving only a total of 29% who rated it with a “4” or better.<sup>22</sup> In addition, when asked, “To what extent do you think a buyer, unrepresented by an attorney, would have read the form contract, realized that they should have raised the same important changes you would, and would then be able to raise these points with the seller,” 69.6% of the attorneys surveyed reported a “7,” and 92.1% reported either a “6” or “7” (on a 1-7 scale) that they felt strongly that they did not think they (the buyers) would raise the same points.<sup>23</sup> The results of the Remedies Experiment we ran in connection with spotting problems with the unfair remedies clauses of the contract supports this opinion.<sup>24</sup> These results suggest a need for homebuyers to have an attorney represent the homebuyer at the contract formation/negotiation stage or under an attorney approval of the contract clause. It should also be noted that only 35% of the attorneys reported that they were successful in negotiating a modification or deletion of highly unfair or problematic terms contained in the developer’s form contract greater than 50% of the time.<sup>25</sup> As Part IV of the Article discusses, this result suggests the need to create legislation prohibiting the most unfair and problematic terms developers use in their form contracts, especially ones that laypersons do not understand. Finally, we asked attorneys to report how often major disputes arose between the parties after the contract was signed (before or after closing the deal).<sup>26</sup> Approximately half of respondents (50.5%) reported that such major disputes arose in only 1-10% of the matters they handled, with only 3.8% reporting experiencing such major disputes more than 50% of the time but only

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with author) [hereinafter Attorney Survey]. The Attorney Survey was based upon dissemination of an online survey designed to elicit the opinions and experiences of Illinois real estate attorneys regarding residential real estate form contracts prepared by developers with a focus on the level of fairness of the terms to buyers and ability of the lawyers to negotiate for better terms, but covering other related matters. The form was sent to members of the Illinois State Bar Association and the Chicago Bar Association, various residential real estate attorneys who had listings on Lawyers.com, alumni of The John Marshall Law School, and real estate lawyers located on the Martindale-Hubbell directory. In total, 108 lawyers submitted responses to the survey. A detailed analysis of the Attorney Survey will appear in a future article.

21. *Id.*

22. *Id.*

23. *Id.*

24. Remedies Experiment, *supra* note 8.

25. Attorney Survey, *supra* note 20.

26. *Id.*

9.7% reporting they never had a major dispute arise after the contract was signed.<sup>27</sup> The fact that most reported such a low percentage of major disputes (1-10%) may explain why the Special Master in New Jersey noted no evidence of public harm from having homebuyers unrepresented by attorneys.<sup>28</sup> But this Article disagrees, first, with the belief that it is acceptable even if 1-10% of homebuyers have no remedies when the seller has breached a home purchase contract, and, second, that it does not pose a public harm worthy of state intervention. For example, most states require automobile drivers to obtain casualty insurance due to the likelihood that drivers will, at some point, be involved in a car accident, and motorists must be insured to pay for any damage inflicted on other motorists.<sup>29</sup> One might imagine that a very large percentage of claims are filed each year; yet in 2011, only 1% of policyholders brought bodily injury claims, and the average amount paid on those claims was \$14,848.<sup>30</sup> Only 5% of policyholders brought a claim for collision damages, and the average amount paid on these claims was only \$2869. Similarly, it is the practice of mortgage lenders, and a requirement for FHA insured loans, to require that the borrower obtain casualty insurance on the home as a condition to obtaining the loan.<sup>31</sup> Yet, in 2008 only 6% of insured homeowners filed a claim (97% of claims were for property damage, including theft) on their homeowner's insurance policies.<sup>32</sup> Even though the percentage of insurance claims filed for car insurance and home damage ranges from 1-10%, federal and state laws still require insurance coverage in these areas. Likewise, this Article argues that state laws should require specially trained and licensed attorneys to represent homebuyers at the contract formation stage. Such representation provides a type of "insurance" because the attorneys can review the contract, spot problems, and negotiate changes to the contract to address those problems, consequently placing homebuyers in a far better position when major disputes arise in 1-10% of the deals. If unable to negotiate for changes to address the problems, the lawyer will make the buyer aware of the risks, and some buyers may choose not to proceed with the deal and seek out a safer alternative.<sup>33</sup>

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27. *Id.*

28. *In re* Opinion No. 26 of Comm., 654 A.2d 1344, 1345 (N.J. 1995) (per curiam).

29. Harvey Rosenfield, *Auto Insurance: Crisis and Reform*, 29 U. MEM. L. REV. 69, 70 (1998).

30. *Auto Insurance*, INS. INFO. INST., [http://www.iii.org/facts\\_statistics/auto-insurance.html](http://www.iii.org/facts_statistics/auto-insurance.html) (last visited June 29, 2013).

31. See Kenneth S. Klein, *Following the Money—The Chaotic Kerfuffle When Insurance Proceeds Simultaneously Are the Only Rebuild Funds and the Only Mortgage Collateral*, 46 CAL. W. L. REV. 305, 306 (2010) ("A standard condition of mortgages or, more precisely, the security instruments accompanying mortgages in the United States is that the borrower must have casualty insurance protecting not just the borrower, but also the bank." (internal parentheses omitted)).

32. *Homeowners and Renters Insurance*, INS. INFO. INST., [http://www.iii.org/facts\\_statistics/homeowners-and-renters-insurance.html](http://www.iii.org/facts_statistics/homeowners-and-renters-insurance.html) (last visited June 16, 2013).

33. The area of major dispute most reported in the Attorney Survey was the physical condition of the home (86%), followed by failure to complete on time (58.1%), failure of a

There is another empirical study on the impact of attorney representation in home purchases that has relevant findings. In Braunstein's 1989 study, noted earlier, recent purchasers of homes near Columbus, Ohio, were interviewed in lengthy telephone conversations.<sup>34</sup> Of the 132 homebuyers surveyed, 41% had hired an attorney to represent them in some capacity of the purchase, and the rest had not.<sup>35</sup> He noted that "many of those who hired a lawyer" did so where "the lawyer was involved fairly early in the process," but it is not clear if this refers to the time the contract was being negotiated.<sup>36</sup> When asked why they hired a lawyer, the most frequent response was a vague "to protect me" answer, apparently without any further details.<sup>37</sup> Braunstein notes several areas where the purchasers failed to understand basic real estate laws as applied to their deal: (i) "50[%] did not know whether their deed was a general warranty deed, a limited warranty deed, a quit claim deed, or some other type," (which impacts liability of the seller to the buyer for defects in title and encumbrances); (ii) although many knew they had taken title as joint tenants (only 22.6% did not know how they took title), almost 50% of those who knew they took as joint tenants "did not know the significance of how they held title" (such as rights of survivorship, which might not be what the buyers intended if, for example, it is the couple's second marriage and there are children from the first marriage); and (iii) a large percentage of buyers displayed a substantial lack of understanding of title insurance, with "only 7% realiz[ing] that there were any exceptions to their policy," and over half not realizing "that title insurance did not cover faulty construction, but did cover adverse legal claims to the house and land."<sup>38</sup> Equally problematic is the fact that an "overwhelming majority of buyers were not given a copy of the title policy until at or after the closing"<sup>39</sup> when it is difficult or too late to address title problems disclosed in the title commitment. Some of the home buyers also did not realize that the real estate agent's loyalty was to the seller, and not the buyer, unless the agent was the buyer's agent or a dual agent.<sup>40</sup> These results reflect that the homebuyers were ignorant of important legal matters relating to their home purchases, suggesting that the buyers should be represented by an attorney who is aware of these matters and able to ensure that the buyer's goals and expectations are met. Having said that, a disturbing finding from the telephone interviews was that purchasers who used lawyers were no more educated on relevant legal matters, no more content with the exchange, and no more likely to deflect disagreement than those who did not hire representation.<sup>41</sup> These results show poor diligence by the attorneys who

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condition to close (44.1%), breach of contract (37.6%), title defects (35.5%), and other (12.9%).

34. Braunstein & Genn, *supra* note 10, at 469.

35. *Id.* at 471.

36. *Id.*

37. *Id.*

38. *Id.* at 476-77.

39. *Id.* at 477.

40. *Id.*

41. *Id.* at 479-80.

represented those home buyers<sup>42</sup> and the authors here contend underscore the need for attorneys who practice in this area of law to be specially trained and licensed in order provide real value to their clients.<sup>43</sup>

## II. CONSUMER UNDERSTANDING OF REMEDIES EXPERIMENT

### A. *Summary of Background Laws Relating to Contract Remedies Experiment*

Under the common law, the usual contract remedies that can be sought when a party breaches an agreement to sell or buy real estate are as follows: (i) “specific performance” (i.e., the right to force the other party to close the deal, with the buyer paying the purchase price and the seller deeding the property to the buyer);<sup>44</sup> (ii) benefit of the bargain damages,<sup>45</sup> also sometimes referred to as expectation damages or “loss-of-bargain damages,” which calculation is based upon the difference between the fair market value of the real estate on the date of the breach and the contract price<sup>46</sup> (for example, if the contract price is \$100,000, and the fair market value is \$115,000, if the seller breaches the contract, the buyer can recover \$15,000 in expectation damages); (iii) reliance damages, which are based upon any expenditures made by the non-breaching party in order to perform under the contract (if the seller breaches the contract, and the buyer has incurred expenses, such as expenditures from securing financing paying for a home appraisal or inspection, the buyer can recover these expenses as their reliance damages);<sup>47</sup> (iv) “restitution and rescission,” which means termination of the contract and return of any sums the non-breaching party has paid to the other party (such as the earnest money);<sup>48</sup> (v) incidental damages, which are damages that arise due to breach of the contract that the breaching party could have reasonably anticipated and which the non-breaching party could not have reasonably avoided<sup>49</sup> (such as the buyer having to pay a fee to the lender to obtain the same interest rate on the loan if during the closing delay the interest rate increased); and (v) liquidated damages, which is an agreement in the contract

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42. Braunstein did note that while 41% of those surveyed said they hired their own lawyers to help them purchase the house, a later question revealed that nine of the fifty-four respondents paid no fee to their lawyer, and two of the fifty-four said they never had met or spoke with their lawyer. *Id.* at 471 & n.5.

43. Alan M. Weinberger, *Some Further Observations on Using the Pervasive Method of Teaching Legal Ethics in Property Courses*, 51 ST. LOUIS U. L.J. 1203, 1205 (2007) (stating “transactional real estate practice generates a greater proportion of legal malpractice claims than any other field (twenty-five percent)”). See also *infra* Part IV.

44. See WILLIAM B. STOEBUCK & DALE A. WHITMAN, *THE LAW OF PROPERTY* § 10.5, at 738 (3d ed. 2000).

45. *Id.* § 10.3, at 724.

46. *Id.*

47. *Id.* at 727-28.

48. *Id.* § 10.7, at 748-49.

49. *Id.* § 10.3, at 727-29.



of the damages that the breaching party will owe as a specified amount (such as, for a breach by the buyer, the amount of money serving as the earnest money deposit [typically an amount between 5-10% of the purchase price]). This liquidated amount is generally due notwithstanding the actual damages the non-breaching party might otherwise recover<sup>50</sup> (i.e., if the actual damages end up being more or less than the liquidated amount, the liquidated amount, would control). The amount must be a reasonable estimate of damages at the time the contract is entered into.<sup>51</sup>

With the exception of liquidated damages, the other remedies exist even if a contract is silent on the issue of remedies.<sup>52</sup> When a contract attempts to limit any of these otherwise available remedies, this is called an “exculpation clause” or a “limitation of liability” clause, which exist in the “clearly unfair” and “vaguely unfair” contract conditions categories described below.<sup>53</sup> As will be discussed in detail in Part II, most exculpation/limitation of liability clauses are enforced but may not be enforced by some courts in extreme cases. The list of remedies described above (except for liquidated damages) would all apply to the “fair” contract condition. The possibility of recovering attorneys’ fees to enforce the agreement is a special category and is not covered by the common law as a remedy for breach of contract.<sup>54</sup> To recover attorneys’ fees for enforcing the agreement and to seek remedies after a breach, one needs either to specially provide for this in the agreement (as done in the fair contract condition but not in the clearly unfair or vaguely unfair contract conditions), or there must be a statute on point that covers the situation (for example, a consumer fraud claim).<sup>55</sup> There are also limits to the combination of remedies that a non-breaching party can recover, such as not being able to recover both specific performance or benefit of the bargain damages and also reliance-type damages.<sup>56</sup>

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50. *Id.* § 10.4, at 733.

51. *Id.* at 734. To be enforceable, the amount must “be a reasonable estimate,” at the time the parties enter into the contract, of the amount of damages the non-breaching party will sustain. *Id.* at 734-35. But some courts will look at the actual damages, and if they are far less than the liquidated amount, might rule that the liquidate amount is a penalty and not enforceable. *Id.* at 735.

52. RESTATEMENT (SECOND) OF CONTRACTS §§ 344-346 (1981).

53. See 8 RICHARD A. LORD, WILLISTON ON CONTRACTS § 19:25 (4th ed. 2012).

54. RESTATEMENT (SECOND) OF CONTRACTS § 345; see *Clevert v. Jeff W. Soden, Inc.*, 400 S.E.2d 181, 183-84 (Va. 1991) (awarding attorney’s fees because the contract contained a provision requiring the defaulting party to pay them).

55. *Fleischmann Distilling Corp. v. Maier Brewing Co.*, 386 U.S. 714, 717 (1967) (“The rule here has long been that attorney’s fees are not ordinarily recoverable in the absence of a statute or enforceable contract providing therefor.”).

56. The participant responses on this issue reflected a lack of knowledge of such limitations. Details of these results are on file with the second author. We asked participants questions related to that and since this knowledge is not relevant to how the contract remedies clause should be drafted, we are not reporting in this Article the results from those questions.

### *B. The Consumer Remedies Experiment*

In designing the Consumer Remedies Experiment, we were inspired by a similar study conducted by Stolle and Slain in 1997.<sup>57</sup> In their study, participants imagined that they were injured while using exercise equipment at a health club in one scenario and imagined that their car was scratched in a repair shop in another.<sup>58</sup> Participants reviewed the exculpation clauses in the gym's and the shop's contracts.<sup>59</sup> The language, if enforceable, would have severely restricted the gym's and the shop's liability.<sup>60</sup> Two-thirds of the participants correctly identified that there was a clause that prevented their potential for recovery in a lawsuit.<sup>61</sup> In 2011, the authors of this Article conducted an experiment to investigate the abilities of individuals to understand restrictive remedies clauses in home purchase contracts and the methods and results of this experiment are described below.<sup>62</sup>

#### *1. Methods.—*

*a. Participants.*—One hundred seventy-seven undergraduate students completed the questionnaire for course credit. Participants were randomly assigned as follows: fifty-two to the fair condition, sixty-five to the clearly unfair condition, and sixty to the vaguely unfair condition. The sample was 64.9% female, 62.5% white, 13.6% Hispanic, 5.7% Asian American, 5.7% African American, and 2.3% Native American. The majority of participants identified as Democrats (52.3%), followed by Independents (19.3%), Republicans (13.6%), Libertarians (7.4%), and Green Party (3.4%). Participants rated their family income levels as high (6.8%), upper-middle (39.7%), middle (42.0%), or low (8.0%). These participants had little to no personal experience with home purchase scenarios like the one described in this experiment. They were asked whether they had ever had an experience similar to this one and to respond on a 7-point scale with “1” representing “not at all similar,” “4” representing “somewhat similar,” and “7” representing “very similar.” The average response was 1.37. Participants were also asked how reputable they thought most professional real estate developers are in general on a 7-point scale with “1” representing “not at all reputable,” “4” representing “somewhat reputable,” and “7” representing “very reputable.” The average response was 4.20.

*b. Materials and procedure.*—Participants entered the laboratory and were given a randomly assigned questionnaire with either a fair, clearly unfair, or vaguely unfair remedies clause.

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57. Dennis P. Stolle & Andrew J. Slain, *Standard Form Contracts and Contract Schemas: A Preliminary Investigation of the Effects of Exculpatory Clauses on Consumers' Propensity to Sue*, 15 BEHAV. SCI. & L. 83 (1997).

58. *Id.* at 87.

59. *Id.*

60. *Id.*

61. *Id.* at 88.

62. Remedies Experiment, *supra* note 8. The following information, including the *Methods*, *Results*, and subsequent analysis are all attributed to the Remedies Experiment.

In the “*fair condition*” questionnaire, the remedies clause read,

*In the event of default by Seller or Buyer, the Parties are free to pursue any legal remedies at law or in equity. The prevailing party in litigation shall be entitled to collect reasonable attorney’s fees and costs from the losing party as ordered by a court of competent jurisdiction.*

This clause provides both parties with equal protection. Both parties are free to pursue all of the legal remedies described above and liabilities were reciprocal.

In the “*clearly unfair condition*” group, the remedies clause read,

*In the event this sale is not closed within sixty (60) days from the date hereof, and Buyer is not then in default, then Seller shall, upon written request of Buyer, return Buyer’s earnest money and this Agreement shall become null and void. Seller’s liability in the event of Seller’s breach of the contract shall be limited to the return of Buyer’s earnest money. In the event of Buyer’s default hereunder then the Seller shall retain the earnest money as Seller’s liquidated damages and sole remedy.*

This clearly unfair clause is problematic from the perspective of the buyer, because if the seller defaults, the seller’s liability is limited to the return of the buyer’s earnest money. By contrast, if the buyer defaults, the seller would retain the buyer’s earnest money (a significant sum of money at 5% of the purchase price under the scenario we described in the study). That is, the seller never risks their own money and the buyer, in essence, has waived four potentially significant remedies listed above (specific performance, benefit of the bargain/expectation damages, reliance damages, and consequential damages) even though those remedies were not specifically noted as being waived in the clause.

In the “*vaguely unfair condition*” questionnaire, the remedies clause was identical to the remedies clause in the *clearly unfair condition* except that the words “*in the event of Seller’s breach of the contract*” were dropped from the second sentence, making that sentence simply state, “*Seller’s liability shall be limited to the return of Buyer’s earnest money.*” This change makes it unclear under what circumstances the seller’s liability is limited to return of buyer’s earnest money. It could potentially relate to only a termination of the contract due to a failure of a condition to closing occurring, such as the buyer obtaining financing, as contrasted with having the limitation of liability clause also cover a seller default situation. Because the language is broad, it is likely a court would interpret it to cover the default situation, and the clause is likely to have the same effect as the clearly unfair contract condition clause.

Participants were then told to imagine that they had performed all of the duties required by the contract, including depositing 5% of the purchase price as earnest money (\$10,000) under the contract. They wished to close the deal, but the seller refused. They suspected that the seller had received a better offer, and their attorney advised them that the seller would be in breach of the contract if the seller did not close. In addition, if the deal did not close, they would still owe their attorney \$300 in fees for the work performed on the deal. They had already paid \$400 for an inspection of the home, \$450 for the appraisal report on the

home, and for a credit check to get a loan to purchase this home. They were told to imagine that, based upon an appraisal of the home, the purchase price under the contract was \$15,000 lower than the property, appraised price and that if they desired to buy a comparable home the purchase price would likely be \$15,000 higher. In addition, interest rates had risen since they first locked in the interest rate. The mortgage broker told them that obtaining the same loan with the same interest rate on another house would cost an additional \$1000.

Participants were then asked to answer a series of questions regarding the actions they would take in the scenario, and their interpretations of the rights they would have under the contract. These questions along with participants' responses in each of the three conditions are described in the following results section.

2. *Results.*—

a. *Participants were asked to briefly explain what they would do in similar circumstances.*—We were curious to see if those in the fair condition group stated they would seek more remedies than those in the unfair conditions group in light of the different remedies language in the contracts. Responses were categorized as pursuing legal remedies, such as suing or speaking to an attorney, or not pursuing remedies beyond the return of the earnest money. When responses were ambiguous as to which category was most appropriate, responses to subsequent questions were used to determine the appropriate category. When it was not possible to categorize responses, they were dropped from analysis. Of the participants who answered the question and had clear responses, more participants indicated that they were inclined to pursue remedies in the *fair condition* group (43/48 or 89.6%) than in the *clearly unfair condition* group (38/55 or 69.1%) or in the *vaguely unfair condition* group (30/47 or 63.8%). These differences were statistically significant,  $\chi^2 (2, N = 150) = 9.27, p < .01$ .<sup>63</sup>

b. *Participants were asked how similar they thought the remedies clause in the contract was to those used by most professional real estate developers.*—They answered on a 7-point scale, with “1” representing “not at all similar,” “4” representing “somewhat similar,” and “7” representing “very similar.” This question was intended to get a sense of whether the participants assumed the remedies clause was typical or not. If there was no statistical difference in the results among the three conditions, it could indicate that there was no knowledge of what is customary. Based on the results from the Condo Contracts Study,<sup>64</sup> the correct answer under the *fair condition* clause would be a “1,” the correct answer under the *vaguely unfair* condition would be a “6” and a “7” under the *clearly unfair* condition.

By contrast, participants in the *fair condition* group gave the fair clause an average of 4.9 on this scale, participants in the *clearly unfair condition* group gave it a 4.7, and participants in the *vaguely unfair condition* group gave it a 4.8. These responses were not different by a statistically significant amount between

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63. This statistic reports the results of a chi-square analysis used to investigate categorical data. P-values less than .05 are considered statistically significant by convention.

64. Condo Contracts Study, *supra* note 1.

conditions,  $F(2, 174) = 0.40, p > .05$ .<sup>65</sup> The finding that ratings differed so drastically from the results from the Condo Contracts Study<sup>66</sup> suggests that the participants did not know what type of remedies clauses are customary. This result underscores the need for consumers to have the necessary contractual scripts and schemas to protect themselves. Our participants lacked these scripts and schemas.

*c. Participants rated how difficult they found it to understand the language of the remedies clause in the contract.*—Participants again based their answers on a 7-point scale, with “1” representing “not at all difficult,” “4” representing “somewhat difficult,” and “7” representing “very difficult.” Prior to running the experiment, we thought that both the *fair* and *clearly unfair* remedies clauses were easy to understand, and the *vaguely unfair* clause was more difficult because it was not clear what situations the limitation-of-remedies related to. While the participants would not have known all of the precise remedies available in the absence of an exculpation/limitation of liability clause, we thought they would at least recognize that they would be limited to a refund of their own money.

Contrary to this original prediction, all participants rated their clause as “somewhat difficult.” Differences were not statistically significant,  $F(2, 174) = 0.92, p > .05$ .<sup>67</sup> Participants in the *clearly unfair condition* group rated this clause a 4.6 in difficulty, participants in the *fair condition* group rated it a 4.3, and participants in the *vaguely unfair condition* group rated it a 4.2; but this difference was not statistically significant despite the major differences in these remedies clauses.

Based on other results from the Consumer Remedies Experiment, it appears that the clearly worded *fair* remedies clause was “somewhat difficult” for them to understand because they did not precisely know what “legal remedies” were available to them “at law or in equity,” legal terminology that any lawyer or judge who has taken a contracts course in law school should readily understand but apparently not understandable to laypersons. Similarly, the clearly worded *unfair* remedy clause was also “somewhat difficult” for them to understand, perhaps because many were not precisely sure what words like “sole remedy” meant. Their admitted difficulties in understanding the clauses most likely accounts for their difficulties identifying the portions of the remedies clause that would prevent them from recovering damages, an issue discussed below.

*d. Participants were asked how likely they would be to demand that the Seller pay for their losses and to rate how successful they thought they would be if they demanded that the Seller pay for their losses.*—Participants used on the same 7-point likelihood scale described above. Prior to running the study, we thought that participants who were given the *fair* remedies clause would have been most likely to make this demand, followed by the *vaguely unfair* and *clearly*

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65. This statistic reports the results of an analysis of variance used to investigate quantitative values such as ratings. P-values less than .05 are considered statistically significant by convention.

66. *Id.*

67. *See supra* note 65.

*unfair* clauses. After all, the *fair remedies* clause would have given the participants who were given that clause grounds for making this demand.

Contrary to this original prediction, the type of remedies clause did not have a substantial effect on participants' ratings of how likely they would be to make this demand. Participants given the *fair* clause rated their likelihood of making this demand a 5.8, participants given the *clearly unfair* clause rated their likelihood a 5.5, and participants given the *vaguely unfair* clause rated their likelihood a 5.6. These ratings were quite high, between "somewhat likely" and "very likely," but did not statistically differ across conditions,  $F(2,172) = 0.42$ ,  $MSE = 2.88$ ,  $p > .05$ .<sup>68</sup>

The finding that participants' responses did not differ across the different remedies clauses reflects a lack of understanding of the impact of the contract remedies language on their rights to recover their losses (Why make a demand for losses if you are unlikely to be able to recover on this demand?). It may also reflect a failure to understand the types of losses they could be recovering—depending on the language in the contract—with some viewing the loss of their earnest money paid as their only loss (perhaps due to the language in all three contracts that refer to this possible loss), versus the range of other losses they would be compensated for under the law.

Participants were optimistic on the question of how successful they thought they would be in making demands. If knowledgeable of the impact of the remedies clause language, participants who were given the *fair* remedies clause would rate a likely chance of success, and participants who were given the *vaguely unfair* and *clearly unfair* clauses would rate a less likely chance of success. However, participants in the *fair condition* group were unduly pessimistic, and participants in the *clearly unfair* and *vaguely unfair conditions* groups were unduly optimistic about their chances given how those remedies clauses read. Responses were all in the "somewhat successful" range and did not differ across the different remedies clauses by a statistically significant amount,  $F(2,172) = 1.57$ ,  $MSE = 2.66$ ,  $p > .05$ .<sup>69</sup> Participants given the *fair* clause rated their likelihood of success as 4.5; whereas, participants given the *clearly unfair* clause rated their likelihood a 3.9, and participants given the *vaguely unfair* clause rated their likelihood a 4.2. These are all small differences without statistical or practical significance. These results suggest that participants either did not understand the legal consequences or implications of the remedies clauses they were given or possibly confined their understanding of "losses" in the two *unfair* conditions clauses to their earnest money.

*e. Similar to the study performed by Stolle and Slain (1997),<sup>70</sup> participants were asked whether the remedies clause in the contract might prevent them from recovering on their demand.*—We asked this because participant answers to the question of their likelihood of success may have been influenced by their beliefs regarding the legal system (i.e., whether the legal system is fair or rigged against

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68. See *supra* note 65.

69. See *supra* note 65.

70. Stolle & Slain, *supra* note 57.

them), rather than making an appraisal based upon the actual reading of the remedies clauses. To address this question and focus more specifically on the reading of the remedies clause, participants were asked, as a simple “yes” or “no” question, whether they thought that the remedies clause in the contract, as opposed to other factors, might prevent them from recovering on their demand. The normative answer was “no” in the *fair condition* group and “yes” in the *clearly unfair* and *vaguely unfair conditions* groups. Consistent with the normative answer, approximately two thirds of participants (68.0%) in the *fair condition* group correctly answered “no.” This left, however, approximately one-third of the participants given the *fair* clause who failed to comprehend how *fair* the fair remedies clause was. Although 65.6% of participants who were given the *clearly unfair* clause correctly answered “yes,” 34.4% failed to comprehend how the wording of that clause would prevent them from recovering on their demand. The percentages in the Remedies Experiment who stated “yes” to understanding there is a limitation on what remedies they can recover is similar to the percentage in Stolle and Slain’s experiment of those who identified the clause—after reading the entire contract—that limited their ability to recover in a lawsuit.<sup>71</sup> We did not provide an entire contract in the Remedies Experiment but only provided them with the limitation of remedies clause.

When we asked the participants to circle the portion of the clause that limited their remedies (discussed in the next section), participants were much less likely to correctly do so than the two-thirds of participants who correctly identified that the clause limited their remedies. This finding suggests that participants may have been guessing when they identified that the clause limited their liability as they could not correctly explain their response. Also troubling, was the finding that only 44.1% of participants who were given the *vaguely unfair* remedies clause correctly answered “yes.” Thus, more than half of the participants (55.9%) failed to comprehend how the wording of that clause would prevent them from recovering on their demand. The differences between these groups were statistically significant,  $\chi^2(2,173) = 13.43, p < .01$ <sup>72</sup> with the participants in the *vaguely unfair condition* group the most likely to fail to comprehend how the remedies clause would affect their likelihood of succeeding in recovering their losses. This is consistent with one of our hypotheses that consumers under the *vaguely unfair* clause are less likely to realize how their remedies have been reduced than those in the clearly unfair clause. It should be noted, however, that the other two conditions also reflected a significant amount of inaccurate understandings on this issue.

*f. Participants were asked to circle the portions of the remedies clause that might prevent them from recovering.*—Of those given the *fair* clause, where nothing prevented them from recovering, seventeen participants out of fifty-two (32.7%) incorrectly circled something. In the *clearly unfair* clause, the words “limited to” in the sentence “Seller’s liability in the event of Seller’s breach of the contract shall be limited to the return of Buyer’s earnest money” was the key

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71. *Id.*

72. *See supra* note 63.

portion that prevented recovery. Likewise, in the *vaguely unfair* clause, the words “limited to” in the sentence “Seller’s liability shall be limited to the return of Buyer’s earnest money” was the key portion that prevented recovery. Only a minority (seventeen out of sixty-five; 26.2% of participants given the *clearly unfair* clause) correctly circled those words in that sentence. Even fewer (six out of fifty-seven; 10.5%) correctly circled those words when given the *vaguely unfair* clause. This difference between the *clearly unfair* and *vaguely unfair* clauses was statistically significant,  $\chi^2 (1, N = 122) = 8.03, p < .01$ .<sup>73</sup>

*g. Participants were asked how likely they would be to seek advice from an attorney.*—Participants based their answers on the 7-point likelihood scale described above. Ratings were high for all three conditions but were not lower in the fair condition than in the *clearly unfair* and *vaguely unfair* conditions,  $F(2, 174) = 0.17, MSE = 1.38, p > .05$ .<sup>74</sup> Participants rated themselves a 6.3 (very likely) on this scale in the *fair condition* group, 6.3 in the *clearly unfair condition* group, and 6.2 in the *vaguely unfair condition* group. This finding suggests that it is not clear to the participants what rights they have under the remedies clauses and would benefit from advice of an attorney on this.

*h. Participants were asked, assuming their attorney had advised them that a lawsuit was possible, to rate on the likelihood scale described above how likely they would be in successfully recovering what they desired in a lawsuit.*—This question is similar to the earlier question of the likelihood of recovering losses upon demand but is different in two ways. This question, by referring to a lawsuit, clarifies that a judge is making the decision now, versus “demands” where the seller may be deciding. Second, by referring to recovering what they “desire,” this question expands on the recovery notion by asking participants to consider what they desire (for example getting the property) versus just recovering their losses (such as earnest money and out of pocket expenses). The normative answer should have been “7” (very likely) for participants who were given the *fair* clause, “1” (not at all likely) for participants who were given the *clearly unfair* clause, and “1.5” for participants who were given the *vaguely unfair* clause, in light of the summary of background laws on contract remedies previously provided. Contrary to these normative answers, responses were all slightly above “somewhat likely,” and while they differed by an amount that is considered marginally significant,  $F(2, 174) = 2.94, MSE = 1.82, p = .06$ ,<sup>75</sup> they did not differ by an amount that would have practical consequences. The average of the responses of the participants given the *fair* clause were 5.2, the average of the responses of the participants given the *clearly unfair* clause was 4.8, and the average of the responses of the participants given the *vaguely unfair* clause was 4.5. Again, since the responses to this question on the likelihood of being successful in a lawsuit across conditions did not statistically differ, this is evidence that consumers did not understand the impact of the contract language on what they can recover for a breach of contract.

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73. See *supra* note 63.

74. See *supra* note 65.

75. See *supra* note 65.



*i. Participants were asked how successful they thought they would be in a lawsuit to recover five specific losses.*—These losses included: (1) attorneys' fees for negotiating the contract and handling the matter before the default (an example of reliance damages); (2) attorneys' fees for handling the litigation (only recoverable if the contract or applicable statute provides for attorneys' fees); (3) the \$400 paid for the inspection and \$450 for the appraisal report and credit check to obtain the loan (examples of reliance damages); (4) the \$10,000 for the difference between the fair market value of the home and the purchase price (the expectation/benefit of bargain damages); and (5) the \$1000 to obtain a new loan at the same rate (although rates have risen) to close on the purchase of a home (an example of consequential damages). In addition to this general question regarding how successful they thought they would be on each of these items, participants were asked more specifically, as "yes" or "no" questions, whether the remedies clause or any laws on remedies might prevent them from recovering. In general, participants who were given the *fair* remedies clause were unduly pessimistic, and participants who were given the *clearly unfair* and *vaguely unfair* remedies clauses were unduly optimistic. Each result reflects a major lack of understanding of the impact of the contract language on what they could recover.

*(1) Recovery of attorneys' fees for negotiating the contract and handling the matter before default:*

On the question asking the likelihood of recovering attorneys' fees for negotiating the contract and handling the matter before the default, the normative answer should have been a "7" among participants who were given the *fair* remedies clause, a "1.5" among those given the *clearly unfair* remedies clause, and a "2" among those given the *vaguely unfair* remedies clause, based on the laws relating to contract remedies summarized earlier.<sup>76</sup> Consistent with these normative answers, the remedies clause affected participants' judgments by a statistically significant amount,  $F(2,174) = 3.95$ ,  $MSE = 3.71$ ,  $p < .05$ ,<sup>77</sup> although the majority of responses were in the "somewhat likely" range. Responses of participants who were given the *fair* clause (mean = 4.8, slightly above "somewhat likely") differed from the responses of participants who were given the *clearly unfair* clause (mean = 3.7, slightly below "somewhat likely"),  $t(115) = 3.08$ ,  $p < .01$ , and the responses of participants who were given the *vaguely unfair* clause (mean = 3.1, slightly below "somewhat likely"),  $t(110) = 4.97$ ,  $p < .01$ .<sup>78</sup> The responses of participants who were given the *clearly unfair* and the *vaguely unfair* clauses did not differ from each other once error control is taken

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76. The attorneys' fees to handle the deal should be treated like other reliance type damages. However, we speculate some courts might confuse this with the attorneys' fees relating to enforcing the agreement (i.e., litigation costs) and mistakenly not permit a recovery of the pre-litigation attorneys' fees.

77. See *supra* note 65.

78. This statistic reports the results of a t-test used to investigate whether the quantitative values from one group differ from the quantitative values from a second group (only works when there are two groups). P-values less than .05 are considered statistically significant by convention.

into consideration,  $t(123) = 1.90, p > .017$ .<sup>79</sup>

To try to understand the factors that could have affected participants' judgments on the likelihood of recovering attorneys' fees for negotiating the contract and handling the matter before the default, participants were also asked to indicate as simple "yes" or "no" answers whether there were any portions of the remedies clause or, in a separate question, any laws of remedies that could prevent them from recovering. The normative answer should have been "no" among participants who were given the *fair* remedies clause and "yes" among participants who were given the *clearly unfair* and *vaguely unfair* remedies clauses because, under the *fair* condition, the buyer has not waived her right to recover reliance type damages. Consistent with these normative answers, 73.1% of the participants who were given the *fair* remedies clause correctly identified that the remedies clause would not prevent them from recovering, leaving 26.9% of the participants who incorrectly believed there were portions that could prevent them from recovering. More troubling, however, is the finding that 55.4% of participants who were given the clearly unfair remedies clause and 51.7% of participants who were given the vaguely unfair remedies clause (i.e., more than half) incorrectly believed that no portion of their remedies clause would prevent them from recovering attorneys' fees incurred before the default, even though the clauses, especially the clearly unfair one, states the buyer's sole remedy in the event of the seller's breach is return of the buyer's earnest money. The differences between groups were marginally significant,  $\chi^2(2, N = 177) = 5.95, p = .05$ ,<sup>80</sup> but the number of participants who failed to understand how their remedies clause would prevent them from recovering was troubling.

(2) *Recovery of attorneys' fees for handling the litigation (only recoverable if the contract provides for this or a statute does):*

On the question of recovering attorneys' fees for handling the litigation, the normative answer is "7" ("very likely") under the *fair* condition and "1" ("not at all likely") in the *clearly unfair* and *vaguely unfair* conditions. This is because laws of remedies prevent plaintiffs from recovering attorneys' fees for handling litigation unless the contract states otherwise,<sup>81</sup> and the *fair* condition contract clause provides for recovery of these fees to the prevailing party. Our participants were not lawyers, so they were not likely aware of this requirement for recovering attorneys' fees. Perhaps because the *fair* condition explicitly spells out recovery of attorneys' fees in this situation, which the other two conditions did not, responses differed according to the remedies clause that participants were given by a statistically significant amount,  $F(2, 174) = 14.15, MSE = 3.12, p < .01$ .<sup>82</sup> Responses of participants who were given the *fair* clause (mean = 4.8, slightly above "somewhat likely") differed from the responses of

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79. See *supra* note 78.

80. See *supra* note 63.

81. See, e.g., *Timberland Forest Prods., Inc. v. Franks*, No. SD 31898, 2013 WL 941828, at \*5 (Mo. Ct. App. Mar. 12, 2013); *Shelton v. Ritz Carlton Hotel Co.*, 550 F. Supp. 2d 74, 82 (D.C. Cir. 2008); *Taylor v. Pekins Ins. Co.*, 899 N.E.2d 251, 256 (Ill. 2008).

82. See *supra* note 65.

participants who were given the *clearly unfair* clause (mean = 3.2, slightly below “somewhat likely”),  $t(115) = 5.37, p < .01$ , and the responses of participants who were given the *vaguely unfair* clause (mean = 3.5, slightly below “somewhat likely”),  $t(110) = 3.93, p < .01$ . The responses of participants who were given the *clearly unfair* and the *vaguely unfair* clauses did not differ from each other,  $t(123) = 0.92, p > .05$ .<sup>83</sup> Despite these statistically significant differences, the participants who received the *clearly* and *vaguely unfair* clauses were unduly optimistic, and the participants who received the *fair* clause were unduly pessimistic once we consider the normative answers. Participants who were given the *fair* remedies clause were not statistically less likely (38.5%) to believe there were portions of the remedies clause that would prevent them from recovering attorneys’ fees for handling the litigation than participants who were given the *clearly unfair* remedies clause (49.2%) or participants who were given the *vaguely unfair* remedies clause, 48.3%,  $\chi^2(2,177) = 1.59, p > .05$ . Over 70.8% who were given the *clearly unfair* clause, and 76.3% who were given the *vaguely unfair* clause incorrectly believed there were no laws of remedies that would prevent them from recovering on this issue, while 23.1% of participants who were given the *fair* clause incorrectly believed there were laws of remedies that would prevent them from recovering on this issue (*participants’ responses did not differ according to the remedies clause they received*,  $\chi^2(2,176) = 0.73, p > .05$ ).<sup>84</sup> These results reflect a material misunderstanding of the law relating to recovery of attorney’s fees in an action to enforce the contract.

(3) *Recovery of the \$400 paid for the inspection and \$450 for the appraisal report and credit check to obtain the loan (examples of reliance damages):*

On the question of recovering the \$400 paid for the inspection and the \$450 for the appraisal report and credit check to obtain the loan, the normative answer should have been a “7” among participants who were given the *fair* remedies clause, a “1.5” among those given the *clearly unfair* remedies clause, and a “2” among those given the *vaguely unfair* remedies clause for the reasons previously explained in the summary of the law of contract remedies. Responses differed according to the remedies clauses that participants were given by amounts that are considered marginally significant,  $F(2,174) = 2.64, MSE = 3.56, p = .07$ .<sup>85</sup> Participants who were given the *fair* remedies clause rated their likelihood of recovering the monies higher than participants who were given the *clearly unfair* remedies clause (mean = 4.7 for the fair clause versus mean = 3.9 for the clearly unfair clause) and participants who were given the *vaguely unfair* remedies clause (mean = 4.0); however, the amounts that failed to reach statistical significance once error control was taken into consideration were  $t(115) = 2.24, p > .017$  for the difference between the fair and *clearly unfair* conditions and  $t(110) = 1.81, p > .017$  for the difference between the *fair* and the *vaguely unfair* conditions. The difference between the *clearly unfair* and the *vaguely unfair*

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83. See *supra* note 78.

84. See *supra* note 63.

85. See *supra* note 65.

clauses also failed to reach statistical significance,  $t(123) = 0.23, p > .05$ .<sup>86</sup> These differences suggest that while some participants understood that the *unfair* remedies clauses would prevent them from recovering on this issue, many did not.

Further evidence that many participants did not understand how the unfair remedies clauses would prevent them from recovering the \$400 paid for the inspection and the \$450 for the appraisal report and credit check comes from their answers to the “yes” or “no” question of whether there were any portions of the remedies clause that would prevent this recovery. The differences in responses between participants given the different remedies clauses did not reach statistical significance,  $\chi^2(2,177) = 1.16, p > .05$ .<sup>87</sup> Of the participants given the *fair* remedies clause, 36.5% incorrectly thought that the remedies clause would prevent them from recovering these expenses, and 53.8% of the participants in the *clearly unfair* and 60% of the participants in the *vaguely unfair* remedies clause mistakenly thought that their remedies clauses would not prevent them from recovering these expenses. This lack of understanding of the impact of the exculpation/limitation of liability clause language is much higher than predicted and contrary to assumptions made by courts on consumer understanding of such clauses.<sup>88</sup>

(4) *Recovery of the \$10,000 for the difference between the fair market value of the home and the purchase price (the expectation/benefit of bargain damages):*

On the question of whether participants believed that they could recover the \$10,000 for the difference between the fair market value of the home and the purchase price, the normative answer should have been a “7” among participants who were given the *fair* remedies clause (since it reserved all rights and remedies under the law which would include this type of expectation damages), a “1” among those given the *clearly unfair* remedies clause (since this clause clearly limited the buyer’s remedy to return of the earnest money), and a “1.5” among those given the *vaguely unfair* remedies clause (since this clause was not as clearly limiting of the buyer’s remedy for a seller breach to return of the earnest money). Contrary to these normative answers, responses did not differ according to the remedies clause that participants were given,  $F(2,174) = 1.64, MSE = 3.35, p > .05$ .<sup>89</sup> That is, the average rating of 3.37 for the fair clause, 3.32 for the clearly unfair clause, and 2.82 for the vaguely unfair clause were not different by statistically significant amounts. The average ratings on this question were also lower than the average ratings on the question regarding recovering the \$400 paid for the inspection and the \$450 for the appraisal report and credit check, suggesting that participants were generally skeptical that they could recover such a large amount or that \$10,000 even represented a true loss. Indeed, some of the qualitative responses reflected a sense that this type of recovery was

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86. See *supra* note 78.

87. See *supra* note 63.

88. Goodwin v. Hole No. 4, LLC, No. 2:06-cv-00679, 2007 WL 2221066, at \*8-9 (D. Utah July 31, 2007).

89. See *supra* note 65.

inappropriate. Some of the responses included: “not really money I’m out, never owned the house in full,” “seems not solid, by that I mean that it’s hard to award buyer with theorized money,” and “the seller does not have to reimburse the buyer for offering a good deal.” These responses reflect a lack of understanding of benefit of the bargain/expectation type damages, which is a less obvious “loss” than out-of-pocket expenses related to performing under the contract. This result underscores the importance of a home-buyer being represented by an attorney at the contract formation stage, for attorney approval of the contract condition so that they may negotiate for a “fair” remedies clause, and an attorney to advise the buyer of the recoveries she may be entitled to after a breach. In addition, participants also did not understand how the *unfair* remedies clauses would prevent them from recovering the \$10,000 for the difference between the *fair* market value of the home and the purchase price as evidenced by their answers to the “yes” or “no” question of whether the remedies clause would prevent them from recovering on this issue. Although 50% of participants given the fair remedies clause incorrectly thought their remedies clause would prevent them from recovering on this issue, over 60% given the *clearly unfair* clause and 55% given the *vaguely unfair* clause thought the clause prevented recovery. These between-group differences were not statistically significant,  $\chi^2(2,177) = 1.17, p > .05$ .<sup>90</sup>

(5) *Recovery of the \$1,000 to obtain a new loan at the same rate (although rates have risen) to close on the purchase of a home (an example of consequential damages):*

On the question of whether participants believed they could recover the \$1000 to obtain a new loan at the same rate (although rates had risen), the normative answer should have been a “7” among participants who were given the *fair* remedies clause (because the contract clause reserved all rights and remedies which would include consequential damages),<sup>91</sup> a “1” among those given the *clearly unfair* remedies clause (because this clause clearly limited liability for the seller’s breach to return of the earnest money), and a “1.5” among those given the *vaguely unfair* remedies clause (because this clause less clearly limited the liability to return of the earnest money in the event of the seller’s breach). However, the 3.62 rating by participants who were given the *fair* clause was not statistically significantly higher than the 3.12 rating by participants who were given the *clearly unfair* clause or the 3.08 rating by participants who were given the *vaguely unfair* clause by a statistically significant amount,  $F(2,174) = 1.44, MSE = 3.34, p > .05$ .<sup>92</sup> In addition, answers to the “yes” or “no” question of whether the remedies clause would prevent them from recovering on this issue

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90. See *supra* note 63.

91. This type of loss naturally arises from the breach due to the resulting delay in closing on the loan for another property as a result. It would be awarded as consequential damages if a court determines the breaching party should have reasonably anticipated this type of loss under the circumstances (such as the presence of a financing contingency in the contract) and provided the non-breaching party shows she had taken reasonable steps to avoid this loss.

92. See *supra* note 65.

did not differ depending upon the remedies clause,  $\chi^2(2,177) = 0.58, p > .05$ .<sup>93</sup> The 51.9% of participants who thought that the *fair* clause might prevent this did not statistically differ from the 58.5% who thought that the *clearly unfair* clause might prevent it or the 53.3% who thought that the *vaguely unfair* clause might prevent it. Similar to the results on recovery of benefit of bargain/expectation damages, the percentage of participants who thought they could recover this consequential damage, even in the *fair condition*, is much lower than for the out-of-pocket type reliance damages, reflecting a lack of consumer awareness of the appropriateness of recovering consequential damages as a loss.

j. Participants were also asked about their likelihood of success in a lawsuit to force the Seller to sell the home to them at the contracted-for purchase price (the remedy of “specific performance”).—Participants answered this question on a 7-point scale with “1” representing “not at all likely,” “4” representing “somewhat likely,” and “7” representing “very likely.” Normative answers were “7” given the *fair* clause (since this clause reserved all rights and remedies under the law which would include the right to specific performance), “1.5” given the *clearly unfair* clause (a very low likelihood because of the clear language that says return of the earnest money is the Seller’s sole liability in the event of Seller’s breach, but as discussed in Part II, there is the possibility of a court refusing to enforce this clause if there is a showing that the seller engaged in a strategic default),<sup>94</sup> and “2” given the *vaguely unfair* clause (since this clause also limited liability of the seller to return of the earnest money but was not as clear this would include the circumstance of a seller breach of contract). Contrary to these normative answers, the 4.27 average rating among participants who were given the *fair* clause was not higher than the 4.5 rating among those given the *clearly unfair* clause or the 4.3 rating among those given the *vaguely unfair* clause,  $F(2,173) = 0.30, MSE = 3.21, p > .05$ .<sup>95</sup> These results demonstrate not only that the participants who were given unfair clauses were overly optimistic, but also, it appears, these participants had no idea how the wording of the clause would undermine their attempt to force the seller to sell the home to them. In the other direction, but equally wrong, the participants in the *fair* condition were unduly pessimistic on their chances of obtaining specific performance and appeared to fail to understand that the words “free to pursue any legal remedies at law or *in equity*” means an action for specific performance. There could, however, have been factors other than the remedies clause that could have affected participants’ responses.

To focus participants’ attention on the remedies clause in particular, participants were asked a “yes” or “no” question whether they thought any portions of the remedies clause might prevent them from forcing the Seller to sell

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93. See *supra* note 63.

94. It is difficult to quantify the likelihood of enforcement in the *clearly* and *vaguely unfair* clauses since there is a difference of opinion among the jurisdictions. Courts in Florida are unlikely to enforce the clauses, while courts in other jurisdictions are more likely to enforce it, unless, in some jurisdictions, there is a showing of “bad faith” as defined by that court. See *infra* Part III.

95. See *supra* note 65.

the home to them at the contracted purchase price. The normative responses were “no” given the *fair* clause and “yes” given the *clearly unfair* and *vaguely unfair* clauses; however, 26.9% of participants given the *fair* clause incorrectly said “yes,” while only 35.9% correctly said “yes” given the *clearly unfair* clause and 31.7% correctly said “yes” given the *vaguely unfair* clause. The responses did not even differ between the groups by a statistically significant amount,  $\chi^2(2,177) = 2.20, p > .05$ .<sup>96</sup> The fact that 64.1% in the *clearly unfair* condition and 68.3% in the *vaguely unfair* condition failed to realize the exculpation/limitation-of-remedies clause would prevent them from obtaining the important remedy of specific performance underscores the lack of consumer understanding of such exculpation/limitation-of-remedies clauses, even when clearly focusing on the words in answering questions.

k. *Participants were asked to circle the portions of the remedies clause that might prevent them from forcing the Seller in a lawsuit to sell the home to them at the contracted-for purchase price.*—Of those given the *fair* clause where nothing prevented them from doing so, (twenty participants out of fifty-two; 38.5%), incorrectly circled something. In the *clearly unfair* clause, the words “limited to” in the sentence “Seller’s liability in the event of Seller’s breach of the contract shall be limited to the return of Buyer’s earnest money” was the key portion. Likewise, in the *vaguely unfair* clause, the words “limited to” in the sentence “Seller’s shall be limited to the return of Buyer’s earnest money” was the key portion. Only a minority of those given the *clearly unfair* clause (thirteen participants out of sixty-five; 20.0%) correctly circled those words in the sentence. Even fewer (five participants out of fifty-seven; 8.8%), however, correctly circled those words given the *vaguely unfair* clause. This difference between the *clearly unfair* and *vaguely unfair* clauses was not statistically significant but would be considered marginal,  $\chi^2(1, N = 122) = 3.04, p = .08$ .<sup>97</sup>

l. *Participants were asked how likely it was that a court of law would uphold the remedies clause in the contract they signed.*—Participants based their answers on the 7-point scale, with 1 representing “not at all likely,” “4” representing “somewhat likely,” and “7” representing “very likely.” The normative answers were “7” given the *fair* clause (because this clause is mutual and reserves all rights under the law), “5.0” given the *clearly unfair* clause (which, although very unfair, is still somewhat likely to be enforced since, as discussed in Part III, based on a review of reported decisions, it appears that most courts have enforced this type of exculpation/limitation of liability clause, although Florida courts have found such clauses to create illusory agreements and have consequently not enforced this type of clause), and 4.5 given the *vaguely unfair* clause (because this clause is not as clear that it covers seller’s breach, a court might rule it does not limit remedies in such a circumstance). The alternative remedies clauses affected responses,  $F(2,174) = 3.03, MSE = 2.02, p = .05$ .<sup>98</sup> Average likelihood ratings given the *clearly unfair* clause (mean = 5.1)

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96. See *supra* note 63.

97. See *supra* note 63.

98. See *supra* note 65.

were lower than the ratings given the *fair* clause (mean = 5.8) by a statistically significant amount,  $t(115) = 2.57, p < .05$ , but not lower by a statistically significant amount than ratings given the *vaguely unfair* clause (mean = 5.5),  $t(123) = 1.14, p > .05$ .<sup>99</sup> These responses were about correct for the *unfair* clauses because the case law on this issue is mixed, but too low for the *fair* clause. Before being encouraged by the participants' "correct" rating in the *unfair* and *clearly unfair* conditions, it should be noted that based on their answers to prior questions, they did not understand the impact of these clauses on what they could or could not recover.

*m. Participants were asked how fair they thought the remedies clause was to the buyer.*—Answers were based on a 7-point scale with "1" representing "not at all fair," "4" representing "somewhat fair," and "7" representing "very fair." The type of clause affected the fairness ratings,  $F(2,174) = 3.98, MSE = 1.04, p < .05$ .<sup>100</sup> Average fairness ratings were higher (mean = 4.44) by a statistically significant amount given the *fair* clause, but the ratings given the *clearly unfair* clause (mean = 3.98) did not differ by a statistically significant amount from the ratings given the *vaguely unfair* clause (mean = 3.95). Given the dramatic difference in fairness of the *fair condition* clause (normative answer was 7) as contrasted with the *clearly unfair* and *vaguely unfair* clauses (normative answer was 1), the fact that the averages hovered in the middle range is further evidence that participants did not understand or appreciate the impact of the language used in the contracts on what rights they would otherwise have had. While some of the participants were able to judge the fairness of the clauses, many could not.

### III. A REVIEW AND CRITIQUE OF JUDICIAL TREATMENT OF "RETURN OF EARNEST MONEY AS BUYER'S SOLE REMEDY" CLAUSES IN HOME PURCHASE CONTRACTS

Based on a review of reported appellate court decisions, courts have enforced contracts clauses that provide that the buyer's sole remedy for the seller's default is return of the buyer's earnest money when this limitation-of-remedy is clearly provided for in the contract,<sup>101</sup> with the notable exception of courts in Florida.<sup>102</sup>

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99. See *supra* note 78.

100. See *supra* note 65.

101. See *Markowitz v. Ne. Land Co.*, 906 F.2d 100, 102-10 (3d Cir. 1990) (ruling that, under Pennsylvania law, the contract clause limiting the buyer's remedy to return of his earnest money plus interest, which the contract clearly stated was the sole remedy in the event of seller default, is enforceable, and, thus, the seller was not obligated to complete construction within two years of the contract date, causing the contract to be subject to the Interstate Land Sales Full Disclosure Act); *Goodwin v. Hole No. 4, LLC*, No. 2:06-cv-00679, 2007 WL 2221066, at \*2, \*6, \*8-9 (D. Utah July 31, 2007); *Hunter v. Wilshire Credit Corp.*, 927 So. 2d 810, 814-15 (Ala. 2005) (enforcing limitation of buyer's remedy for seller's breach to return of earnest money; however, buyer did not raise—and court did not address—issue of unconscionability or illusory promise—rather it focused on which of two contracts controlled); *O'Shield v. Lakeside Bank*, 781 N.E.2d 1114, 1116, 1119 (Ill. App. Ct. 2002) (enforcing limitation of buyer's remedy upon seller's breach to return of buyer's



In some of these cases, the buyer failed to timely raise—or raise at all—the argument that the clause might be unconscionable, unreasonable or create an illusory agreement, and, consequently, the court did not address these issues when enforcing the limitation-of-remedy clause.<sup>103</sup> But courts in Utah and Washington<sup>104</sup> did address arguments raised by buyers that such clauses were unconscionable, against public policy, unfair or unreasonable, and concluded in these cases that the clauses were enforceable, even awarding attorneys' fees to the defaulting seller when the buyer sought to obtain additional remedies.<sup>105</sup> In addition, some courts that would generally enforce this type of limitation-of-remedy clause have articulated a narrow exception to its enforcement if the seller's default was in "bad faith" or if the seller had engaged in fraud or deceptive acts.<sup>106</sup> Some courts have defined this "bad faith" exception to be the

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earnest money; however, buyer's only challenge was that it was a liquidated damages clause and, thus, should allow specific performance in the alternative—an argument the court rejected; court did not address any other challenges to its enforcement); *Claiborne v. Wilson*, 572 So. 2d 1197, 1198, 1200-01 (La. Ct. App. 1990) (enforcing limitation of remedy clause for seller's breach to return of buyer's earnest money; buyer claimed she was coerced into agreement to extend the closing date but did not raise other claims to challenge the limitation of remedy clause, and the court did not address other claims); *Lespinasse v. Fed. Nat'l Mortg. Ass'n*, 2003 N.Y. Misc. LEXIS 795 (N.Y. Civ. Ct. May 22, 2003) (contract contained limitation of remedy for seller breach to return of the earnest money and court enforced this when the seller breached by selling the real property to a third party for more than the contract price with the buyer; court stated it would enforce the limitation-of-remedy clause absent a waiver); *Simpson Dev. Corp. v. Herrmann*, 583 A.2d 90, 92-93 (Vt. 1990) (enforcing the limitation of remedy clause, noting that the buyer failed to raise proper objections to it in a timely fashion and looking to the plain meaning of the provision); *Torgerson v. One Lincoln Tower, L.L.C.*, 210 P.3d 318, 322-24 (Wash. 2009) (en banc) (finding the provision limiting the remedies was not unconscionable).

102. See, e.g., *Sperling v. Davie*, 41 So. 2d 318 (Fla. 1949); *Developers of Solamar, LLC v. Weinbauer*, 18 So. 3d 13 (Fla. Dist. Ct. App. 2009); *Idevco, Inc. v. Hobaugh*, 571 So. 2d 488 (Fla. Dist. Ct. App. 1990); *Terraces of Boca Assocs. v. Gladstein*, 543 So. 2d 1303 (Fla. Dist. Ct. App. 1989); *Port Largo Club, Inc. v. Warren*, 476 So. 2d 1330 (Fla. Dist. Ct. App. 1985); *Ocean Dunes of Hutchinson Island Dev. Corp. v. Colangelo*, 463 So. 2d 437 (Fla. Dist. Ct. App. 1985); *Greenstein v. Greenbrook, Ltd.*, 413 So. 2d 842 (Fla. Dist. Ct. App. 1982).

103. See *Markowitz*, 906 F.2d at 104-06; *Hunter*, 929 So. 2d at 810; *O'Shield*, 781 N.E.2d at 1119; *Claiborne*, 572 So. 2d at 1201; *Lespinasse*, Index No. 216T5N at \*4; *Herrmann*, 583 A.2d at 92-93.

104. See *Goodwin*, 2007 WL 2221066, at \*8-9; *Torgerson*, 210 P.3d at 322-24.

105. See *Goodwin*, 2007 WL 2221066, at \*8-9; *Torgerson*, 210 P.3d at 325-26.

106. See *Hassanally v. Manning Ridell, L.L.C.*, Nos. B171993, B173319, 2006 WL 410700, at \*4-6, \*10 (Cal. Ct. App. Feb. 23, 2006) (stating in dicta that limitation of liability clauses are long recognized in California and enforceable unless unconscionable or against public policy; court stated the clause was enforceable, but because of fraud on the part of the seller, the court permitted the buyer to recover tort damages notwithstanding the contract language); *Tanglewood Land Co. v. Byrd*, 261 S.E.2d 655, 656-57, 660-61 (N.C. 1980) (in responding to the buyer's claim that the limitation-of-remedy clause in the contract made it illusory and unenforceable, the court stated that

situation where the defaulting party has represented she has title to the property to be sold when she knows she does not, or when she has taken steps to impede her title after the purchase contract has been signed.<sup>107</sup> For example, the court in *Kooloian v. Suburban Land Co.*,<sup>108</sup> ruled that it would not enforce a contract provision that limited the buyer's remedy to the return of his earnest money for the seller's inability to convey good title because the seller had contracted to sell certain real estate to a purchaser when the seller had already sold the real estate to someone else.<sup>109</sup> The court therefore affirmed the trial court's awarding damages to the buyer for loss of bargain in that case.<sup>110</sup> Courts in a long line of cases have granted reduced damages for non-willful failures to convey good title but full damages for willful failures due to a recognition that there are many possible causes for title to not be marketable that are not the seller's fault.<sup>111</sup> But there is a split of authority on this with some still allowing benefit of the bargain damages.<sup>112</sup> In addition, some courts rule that a buyer of real estate is not prevented from recovering her out-of-pocket expenses when a party breaches for failing to convey title in good faith.<sup>113</sup> But this Article does not focus on a seller who breaches because she, in good faith, was unable to convey marketable title. Instead, this Article focuses on situations where the defaulting seller has used the limitation of the buyer's remedies clause in order to strategically default (i.e., cancel any deal when the property appreciates in value or the seller discovers the property is worth more than the contract price) or situations involving a breach for other reasons beneficial to the seller (such as increased costs to perform

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under Virginia law (the choice of law in the contract), notwithstanding the language in the contract, if a seller has acted in bad faith in originally undertaking to convey title, or has voluntarily disabled [himself] from making such a conveyance," then the limitation-of-remedy clause is inoperative, and the buyer is still entitled to sue for specific performance or benefit of the bargain damages); *Kooloian v. Suburban Land Co.*, 873 A.2d 95, 100 (R.I. 2005) ("This Court consistently has held that in the absence of 'fraud, bad faith, illegality, misconduct, or any other factor that might alter the legal relationship of these parties,' damages for the breach of a contract to purchase real estate are limited in accordance with the terms of the contract." (quoting *Chapman v. Vendresca*, 426 A.2d 262, 264 (R.I. 1981))).

107. See *Kooloian*, 873 A.2d at 99-100.

108. *Id.* at 95.

109. *Id.* at 99-100.

110. *Id.* at 100.

111. See 11 JOSEPH M. PERILLO, CORBIN ON CONTRACTS § 60.11, at 688-92 & 691 nn.13-14 (rev. ed. 2005).

112. See, e.g., *Donovan v. Bachstadt*, 453 A.2d 160, 165 (N.J. 1982) (purchaser entitled to benefit of the bargain damages where vendor breaches executory contract to convey real property regardless of vendor's good faith); *Smith v. Warr*, 564 P.2d 771, 777 (Utah 1977) ("[B]enefit-of-the-bargain damages are to be awarded for breach, . . . regardless of the good faith of the party in breach. . . ." Recovery is not limited to actual pocket expenses merely because breach was in good, rather than bad faith.).

113. See, e.g., *Brown v. Yacht Club of Couer d'Alene, Ltd.*, 722 P.2d 1062, 1067 (Idaho Ct. App. 1986) (awarding out-of-pocket expenses for vendor's inability to deliver marketable title).

beyond what the seller anticipated).<sup>114</sup>

The court in *Goodwin v. Hole No. 4 LLC* exemplifies the approach of enforcing contract clauses that expressly provide for a limitation of remedy; the *Goodwin* court narrowly interprets what is procedural and substantive unconscionability, while potentially providing a “bad faith” exception to enforcement of the clause if it is shown that the seller exercised it because the property appreciated in value.<sup>115</sup> Because the court in *Goodwin* engaged in mental gymnastics and faulty common assumptions to justify enforcing a highly unfair contract limitation clause against a consumer who was likely deceived into entering into the purchase contract, we engage in a thorough analysis of the details of this decision.

In *Goodwin*, the buyer agreed to buy, and the seller agreed to build and sell to the buyer, a home adjacent to a golf course.<sup>116</sup> The contract provided that if the buyer defaulted, the seller could elect either to retain the earnest money as liquidated damages or pursue specific performance instead.<sup>117</sup> However, if the seller defaulted, buyer’s sole and exclusive remedy was to receive a return of buyer’s earnest money, plus 10% interest on the earnest money from the date of deposit.<sup>118</sup> The buyers argued that they thought the limitation-of-remedy clause was only intended for unintentional defaults by the seller, and they could still sue for specific performance if the seller intentionally defaulted.<sup>119</sup> The court ruled that there was no ambiguity on intent regarding when this clause would apply based on the clear limitation-of-remedies language in the contract and were dismissive of the buyers’ claim that they misunderstood the limitation of remedy clause, noting that the entire contract had been explained to the buyers by the broker.<sup>120</sup> The court also ruled that a letter the buyer received from the broker about locking in the price of the unit by signing the contract did not create ambiguity relating to the limitation-of-remedy clause in the contract.<sup>121</sup> Although the court acknowledged “that Utah courts endeavor to construe contracts so as not to grant one of the parties an absolute and arbitrary right to terminate a contract,” the court found that the limitation of remedies clause did not do this because the seller would still have to return to the buyer the earnest money they paid, plus interest, and because the buyers also had a right to terminate the contract if they failed to obtain financing or if they disapproved certain disclosures.<sup>122</sup> The court also rejected the buyers’ argument that the limitation-of-remedies clause was an unenforceable liquidated damages clause because the

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114. *Goodwin v. Hole No. 4, L.L.C.*, No. 2:06-cv-00679, 2007 WL 2221066, at \*10-11 (D. Utah July 31, 2007).

115. *Id.* at \*11-13.

116. *Id.* at \*1.

117. *Id.* at \*2.

118. *Id.*

119. *Id.* at \*3, \*6.

120. *Id.* at \*7-8.

121. *Id.*

122. *Id.* (internal quotation marks omitted).

clause simply provided for a return of earnest money rather than an agreed upon measure of damages.<sup>123</sup> The court also rejected the buyers' argument that the seller breached Utah's implied covenant of good faith and fair dealing because "this [implied] covenant cannot create rights and duties inconsistent with express contractual terms."<sup>124</sup> In this instance, because the parties had bargained for the limitation-of-remedy clause, "it would be unjustified for [the buyers] to expect more than . . . the return of their earnest money plus ten percent. The parties contracted specifically for the purpose of allowing [the seller] to use [this contract provision] as an escape valve."<sup>125</sup>

The court also ruled that there was no evidence of substantive unconscionability or that the seller had engaged in a deceptive act or practice.<sup>126</sup> The court noted the heavy burden and very demanding test required for a finding that certain terms of a contract are substantively unconscionable: "the terms must be so one-sided as to oppress an innocent party. The situation must be conscience-shocking or 'one in which no decent, fair-minded person would view the results without being possessed of a profound sense of injustice.'"<sup>127</sup> The court further noted that even if the court were to find the clause "to be wholly unreasonable, this would not alone establish substantive[] unconscionability."<sup>128</sup> The court added that there was no indication that the clause left "a harsh or unreasonable effect on the Goodwins" since they had the remedy of return of their earnest money plus 10% interest, and the buyers could have bargained for a different remedies provision but instead agreed to the provision as written.<sup>129</sup> The buyer also argued that the clause violated the Utah Consumer Sales Practices Act ("UCSPA") because the clause allowed the seller to "pick its deal"; if property appreciated in value between when the contract was signed and closing, the seller could terminate without incurring liability for damages and sell to someone else for more, and if the property stayed the same or depreciated in value, the seller could close with the buyer at the contracted for purchase price.<sup>130</sup> The court emphasized that the seller had a legitimate reason for this limitation-of-buyer remedy clause for the buyer: the seller had difficulty estimating the costs to perform the construction of the home due to the location of the home on a hilltop and, thus, needed this limitation of remedy to extricate itself from the contract should the construction costs exceed the purchase price.<sup>131</sup> The court noted there was no evidence that the seller used the limitation-of-remedy clause to get out of the deal in order to sell to another party for a higher price—i.e., if the clause were used by the seller to "pick its deal" based on appreciation or

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123. *Id.*

124. *Id.* at \*9.

125. *Id.*

126. *Id.* at \*10.

127. *Id.* (internal quotation marks and footnote omitted).

128. *Id.*

129. *Id.*

130. *Id.* at \*11.

131. *Id.* at \*6.

depreciation of the value of the property.<sup>132</sup> The court seemed to imply that such deal-picking could be the basis for finding that a seller took advantage of another party in violation of the UCSPA: “Because there is no evidence [the seller] actually used [the return of earnest money and interest penalty] to take advantage of any party, the [buyers’] argument fails to support any inference of bad faith.”<sup>133</sup>

The court also ruled that there was no evidence of procedural unconscionability.<sup>134</sup> The court noted six relevant factors for a finding of procedural unconscionability, which focus on the manner in which the parties entered into the contract and whether it led to the complaining party having no meaningful choice:

(1) whether each party had a reasonable opportunity to understand the terms and conditions of the agreement; (2) whether there was a lack of opportunity for meaningful negotiation; (3) whether the agreement was printed on a duplicate or boilerplate form drafted solely by the party in the strongest bargaining position; (4) whether the terms of the agreement were explained to the weaker party; (5) whether the aggrieved party had a meaningful choice or instead felt compelled to accept the terms of the agreement; and (6) whether the stronger party employed deceptive practices to obscure key contractual provisions.<sup>135</sup>

In applying these factors to the facts of the case, the court stated that the buyers’ strongest argument for finding procedural unconscionability was that the contract differed from the state’s approved form of purchase and sale agreement, which stated in bold-face type at the top of the contract that such form was required by Utah law.<sup>136</sup> The court stated that this might have caused the buyers not to have a “reasonable opportunity to understand the terms,” or that the seller had “employed deceptive practices to obscure key contractual provisions.”<sup>137</sup> However, the court stated there was no evidence that the seller was the stronger party in the bargain because a broker represented the buyers.<sup>138</sup> In addition, the court noted that the broker had told the buyers that the contract “had been modified, flagging the specific modified provisions,” including the clause limiting the buyer’s remedy in the event of the seller’s failure to perform.<sup>139</sup> The court presumed that the broker had also “reviewed each of the terms of the [the real estate purchase contract] with the [buyers].”<sup>140</sup> The court also rejected a finding of procedural unconscionability based on the letter from the broker to the

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132. *Id.* at \*11.

133. *Id.*

134. *Id.* at \*11-12.

135. *Id.* at \*11.

136. *Id.* at \*12.

137. *Id.*

138. *Id.*

139. *Id.*

140. *Id.*

buyers stating that the buyers could lock in the purchase price by entering into the contract. The court ruled there was no indication that the seller had reason to know the buyers were relying on that letter to think they were locking in the purchase price since the express terms in the purchase contract superseded other previous agreements.<sup>141</sup> The court ruled that this contract language made any such reliance on the letter “unreasonable.”<sup>142</sup> Finally, the court noted that there may not have even been a conflict with the letter; if the seller had not exercised its right to terminate by returning the earnest money and 10% interest, the buyers could have purchased the unit for the contracted for purchase price, hence, locking in the purchase price amount.<sup>143</sup>

There are many problems with the *Goodwin* court’s reasoning and application of laws to the facts in the case. The first area of critique relates to the “facts” that the court relied upon in interpreting the parties’ intent relating to the limitation of remedies clause. The court accepted the seller’s allegations that the broker “summarized the terms of the [contract]” and in a later telephone conversation “explained all of the [contract]’s provisions to the Goodwins.”<sup>144</sup> We find these “facts” to be highly implausible. The real estate purchase contract at issue was based on the Utah state form purchase contract, which is six pages long and single-spaced.<sup>145</sup> It would take at least twenty minutes to simply look at each of the words in the contract, let alone take time to stop and try to think about the impact of these words and which options in the form contract to choose. The amount of time it takes to fully comprehend the contract would also have to include the time it takes to explain what rights the parties would have absent these contract terms and how the terms change these rights. To make it all concrete, the explainer would have to provide examples of scenarios of how problems could arise, how those problems would be resolved if the contract were silent, and how the express contract terms would resolve these problems. The first author of this Article devotes at least fifteen to twenty hours of class time in her law school real estate transactions courses to review the laws that relate to the terms of typical home purchase contracts, review various typical scenarios of issues that can arise, and consider how different contract terms can affect the rights and obligations of the parties under these scenarios. She spends at least three hours on contract remedies clauses and remedies laws, generally, since these areas of the law are highly complicated. It is unlikely that real estate brokers are trained at the same level as attorneys on all of these laws and how the contract terms can affect the rights of the parties. It is also unlikely that a broker could impart all of this explanation to a buyer when “reviewing” the contract terms with the buyer.

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141. *Id.*

142. *Id.*

143. *Id.*

144. *Id.* at \*2.

145. UTAH REAL ESTATE COMM’N & OFFICE OF UTAH AT ATTORNEY GEN., REAL ESTATE PURCHASE CONTRACT (effective Aug. 27, 2008) [hereinafter REAL ESTATE PURCHASE CONTRACT], available at [http://realestate.utah.gov/forms/REPC\\_2008.pdf](http://realestate.utah.gov/forms/REPC_2008.pdf).

Furthermore, the buyer's assertion that they lacked an understanding of the meaning of the "clear" language (clear at least to any good lawyer) in the contract that limited their remedies in the event of the seller's breach<sup>146</sup> rings as authentic in light of the results of our Remedies Experiment reported in Part II. Adding to the buyer's difficulty in understanding the limitation of remedies clause here is the fact that the clause does not expressly spell out that failure to keep the construction costs within the seller's estimate is a basis for the seller to terminate the contract. The purchaser was probably completely unaware of this risk and did not think of this possibility when reading that portion of the contract.<sup>147</sup> If the main or sole purpose of the broad termination clause was to address the possibility of construction costs exceeding estimates, then why not specify this in the contract, as the contract narrowly specifies the buyer's right to terminate with no liability if the buyer fails to obtain financing?<sup>148</sup> Perhaps the seller did not want the buyer to be aware of the risk of locking in purchase price.

The court's assertion that the parties had "bargained" for the limitation-of-remedy clause in the contract<sup>149</sup> is also highly questionable. The buyers signed the contract, and the contract contained the limitation-of-remedies clause, but this does not necessarily mean that both parties had "bargained" for this term, or, as the court concluded, that the parties had done so to allow the seller to escape liability in the event of high construction costs. Clearly the seller, who reduced the full range of remedies from that provided in the standard form contract,<sup>150</sup> intended it, but there is no evidence that the buyer intended this change or had "bargained" for this result. In general, when a seller is a professional developer, and the buyer is a consumer/home buyer, the seller provides the contract form and the parties typically only negotiate or customize the purchase price, closing date, and amount and interest rate of the loan.<sup>151</sup> It appears that the majority of

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146. *Goodwin*, 2007 WL 2221066 at \*3, \*6.

147. *Id.* at \*6, \*11.

148. *Id.* at \*8.

149. *Id.*

150. See REAL ESTATE PURCHASE CONTRACT, *supra* note 145. Brokers were required to use the statutory standard form contract, but the parties could modify. The form provided for, at the buyer's election, one of the following remedies: (a) cancellation of the contract and, in addition to return of the buyer's earnest money, a sum equal to the earnest money deposit; (b) sue the seller to specifically enforce the contract; or (c) accept a return of the earnest money and pursue any other remedies available under the law. *Id.* ¶ 16.2.

151. See *infra* note 267 and accompanying text (discussing cases in which courts found that brokers can fill in the blanks of form purchase agreements); see also *Smith v. Boyd*, 553 A.2d 131, 135 (R.I. 1989) ("We note that as the written contract was to be drawn up by the realtors, the parties and their realtors had to discuss what was to be stated in the written agreement. The purchase-and-sales-agreement form is a standardized document, but nevertheless a real estate agent must fill in the blanks. To fill in the blanks, the appropriate information must be discussed by the parties and their agents."); *Gustafson v. V.C. Taylor & Sons, Inc.*, 35 N.E.2d 435, 437 (Ohio 1941) (describing the blanks that get filled in as "the supplying of simple, factual material such as the date, the price, the name of the purchaser, the location of the property, the date of giving possession and the

home buyers in the United States do not have an attorney representing them in the negotiation of the terms of the purchase contracts,<sup>152</sup> and most likely only skim the lengthy purchase agreements they sign; as reflected in our Remedies Experiment, those buyers who carefully read and analyze the typical limitation-of-remedies clauses do not understand what rights they are giving up when agreeing to this clause. In general, the court's statement that the parties could have bargained for a different remedy clause, while technically true, is not reflective of the reality of the experience of home purchase transactions for the vast majority of home purchasers.<sup>153</sup>

Courts need to engage in this fiction because buyers could otherwise argue that they failed to read or understand any term of the contract that they later regret, thus, eroding the goal of certainty of contract.<sup>154</sup> Although courts may need, in the typical case, to engage in this fiction, they should be aware that it is, in fact, a fiction; in cases where the terms are very unreasonable and one-sided, courts should keep this fiction in mind. In this case, that fiction is further buttressed by the fact that the letter from the broker discussing a set purchase price induced the buyer to enter into the contract—the very opposite of what they in fact accomplished when they signed this contract due to the wording of the limitation-of-remedy clause.<sup>155</sup> The broker, who allegedly “explained all of the [contract’s] provisions” to the buyers, likely did not fully inform the buyers that this limitation-of-remedies clause could permit the seller to terminate the deal for any reason, nor did the seller likely expressly disclose to the buyer that the seller could cancel the deal if the construction costs exceeded the seller’s estimates.<sup>156</sup> Because the seller could terminate the contract under this clause for any reason with little consequence, this clause eroded the buyer’s basic goal of entering into the contract to lock in a specific purchase price for the property.

Perhaps if the court had better understood that few consumers understand the remedy clauses when they read them—as evidenced by the Remedies Experiment in Part II—and how little information the broker likely explained to them—compared with what a good attorney would—the court might not have

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duration of the offer requires ordinary intelligence rather than the skill peculiar to one trained and experienced in the law.”). This supports the likelihood that other than those blanks, the parties to a contract are unlikely to discuss and negotiate other points in the contract, especially if the buyer does not hire an attorney to review the contract.

152. See *infra* note 267 and accompanying text (noting that many states permit brokers to fill in form purchase contracts and do not require an attorney to represent the home buyer with the contract formation); Braunstein & Genn, *supra* note 10, at 471 (stating at least 59% of the home buyers in their Ohio study were not represented by an attorney).

153. As Justice Holmes famously noted, “The life of the law has not been logic; it has been experience.” O.W. HOLMES, JR., *THE COMMON LAW* 1 (1881).

154. See Howard Gensier, *The Competitive Market Model of Contracts*, 99 COM. L.J. 384, 388 (1994) (discussing the need for certainty in contracting).

155. Goodwin v. Hole No. 4, LLC, No. 2:06-cv-00679, 2007 WL 2221066, at \*2, \*8 (D. Utah July 31, 2007).

156. *Id.* at \*2.



concluded that the buyer had bargained for this limitation-of-remedy or was unjustified in expecting more than what was expressly provided by the limited remedy.<sup>157</sup> The buyers asserted that they thought they could sue for specific performance.<sup>158</sup> They thought that the clause limiting their remedy only related to defaults that the seller could not avoid—i.e., if the seller did not have good title to the real estate through no fault of their own.<sup>159</sup> Although the language in the clause seems clear to attorneys, the results from the Remedies Experiment indicate that many consumers do not really understand how this type of clause affects their rights when the seller defaults and that buyers tend to have a high expectation of their right to force a defaulting seller to specifically perform the contract.<sup>160</sup> Also, because the seller reserved the right to demand specific performance upon the buyer's default this may have caused the buyers to assume they would have similar rights.<sup>161</sup>

The *Goodwin* case also underscores the very narrow band of protection that is afforded to consumers/home buyers when they enter into form contracts prepared by sophisticated developers. As the court noted, “[W]holly unreasonable” terms that “severely limit[] their legal remedies while providing advantages to [the seller]” do not establish substantive unconscionability, as there is a high burden for a contract term to be considered unconscionable.<sup>162</sup>

Although this Article critiques the *Goodwin* court's articulation of the unconscionability test, as applied to consumer-business transactions, most courts have adopted this test.<sup>163</sup> Regardless, the court's dicta in *Goodwin* that there was no indication that the clause harshly or unreasonably impacted the buyers because they could pursue the refund of their earnest money as a remedy, plus 10% interest; such rationale reflects the failure of courts to recall and place appropriate emphasis on the default rights a buyer is ordinarily entitled to if a contract were silent on this issue.<sup>164</sup> The law provides buyers of real estate a right to compel the seller to sell to the buyer at the contracted purchase price (“specific performance”) because real estate is considered to be unique; this right is the essence of what has been bargained for in the contract.<sup>165</sup> Thus, by limiting the buyers here to the return of their own money, the limitation-of-remedies clause takes away this critical right of specific performance. In addition, if the buyer can show that the fair market value of the property exceeds the contract price, the buyer can, instead, sue for this difference as “expectation interest”

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157. *Id.* at \*8.

158. *Id.* at \*2.

159. *Id.* at \*3, \*6-7.

160. Remedies Experiment, *supra* note 8.

161. *Goodwin*, 2007 WL 2221066, at \*2; *see also* ROBERT B. CIALDINI, INFLUENCE: THE PSYCHOLOGY OF PERSUASION 17-56 (rev. ed. 2007) (discussing reciprocity effects and expectations).

162. *Goodwin*, 2007 WL 2221066, at \*10.

163. *See* RICHARD A. LORD, WILLISTON ON CONTRACTS § 18:10 (4th ed. 2012).

164. *Goodwin*, 2007 WL 2221066, at \*2, \*10.

165. *See* 81A C.J.S. *Specific Performance* § 55 (2013).

damages instead of seeking specific performance.<sup>166</sup> This right was also taken away under the limitation-of-remedies clause—an important remedy if the seller’s title to the real estate is seriously impaired. The buyers in *Goodwin* did not appear to present evidence on the fair market value of the property they had contracted to purchase because specific performance does not require this evidence, as opposed to expectation damages.<sup>167</sup> This does not mean that the limitation-of-remedies clause did not have a profound negative impact on the buyer’s rights as a consequence of the seller’s failure to perform under the contract. In addition to what is lost by the limitation clause, the court over-emphasized the buyer’s remaining contractual remedies.<sup>168</sup> However, the remedy of returning of the buyer’s own earnest money arguably provides no real “contractual” remedy at all. If a buyer deposits money with a seller or a third party—unless that money were in the nature of consideration for an option to purchase or a gift to the seller—either as security for the buyer’s performance or to apply to the purchase price, when the buyer has performed and the seller fails to close, the money is the buyer’s and the seller is indebted to the buyer for the amount deposited with the seller.<sup>169</sup> This obligation to repay the earnest money exists without a clause in the contract calling for his return of money as the buyer’s sole “contract remedy” or the seller will be unjustly enriched.<sup>170</sup> The only true added remedy in the *Goodwin* case was requiring the seller to provide interest on the earnest money at 10% if that rate exceeded market rates at the time.<sup>171</sup>

The court’s conclusion that there was no evidence of bad faith in the case is also problematic.<sup>172</sup> As previously noted, the contract remedies language failed to expressly address the situation of construction costs exceeding the purchase price.<sup>173</sup> If this were the sole or main purpose for the limitation-of-remedies clause in the event the seller failed to close, then the contract clause should have expressly been limited to this or other intended scenarios. This change is necessary to put the buyers on better notice that their deal is conditioned upon the construction costs not exceeding the seller’s estimates and would act similarly to a contract explicitly conditioning the closing upon the buyer’s ability to obtain

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166. RESTATEMENT (SECOND) OF CONTRACTS § 347 (1981).

167. *Goodwin*, 2007 WL 2221066, at \*7-8; RESTATEMENT (SECOND) OF CONTRACTS § 347 (1981).

168. *Goodwin*, 2007 WL 2221066, at \*10.

169. Although the return of this money is also covered under the contractual remedy of restitution, it has been construed as in the nature of recovering a debt owed to the purchaser when it was given to the purchaser to be applied to the purchase price. *Kopis v. Savage*, 498 N.E.2d 1266, 1270 (Ind. Ct. App. 1986). See also *STOEBUCK & WHITMAN*, *supra* note 44, § 10.4, at 734 (“[T]he buyer who seeks a refund of earnest money is arguably not relying on contract rights, but is merely asking relief from the seller’s unjust enrichment.”).

170. *STOEBUCK & WHITMAN*, *supra* note 44, § 10.4, at 734.

171. *Goodwin*, 2007 WL 2221066, at \*6.

172. *Id.* at \*9, \*11.

173. *Id.* at \*2-3.

financing. Such a change contrasts with a broadly worded termination right that implicitly encompasses a contemplated risk. By creating the broad-based right to terminate without liability, the seller reserves the right to make any number of post hoc justifications for terminating as a defense to the buyer's argument about whether the seller terminated in order to take advantage of a better offer. The limitation-of-remedies clause is also problematic because it does not include a bad faith exception.<sup>174</sup> This failure may evidence an intention by the seller to reserve the right to use the clause in an opportunistic fashion—to terminate if the fair market value of the property has gone up. The *Goodwin* court could have ruled that the clause, since not so expressly limited, created an illusory agreement—as courts in Florida have.<sup>175</sup>

The *Goodwin* court only briefly applied some of the facts of the case to the law relating to procedural unconscionability.<sup>176</sup> The court focused on the seller's change of the Utah approved form of contract as a basis for the buyers to argue that they did not have a reasonable opportunity to understand the terms of the contract or to argue that the seller engaged in deceptive acts.<sup>177</sup> The court was correct to point out that the broker informed the buyer that the standard form had been revised, but as previously noted, the court placed too much reliance on the broker's ability—and perhaps desire—to inform the buyers of the legal consequences of these changes relevant to the remedies issue.<sup>178</sup> In addition, the court placed far too much weight on the fact that the buyers received “representation” from the broker and, thus, might have been the “stronger party in the bargain.”<sup>179</sup> To the contrary, it is highly likely that the seller/developer here was represented by an attorney. This attorney would likely have advised the seller on how to revise the standard form purchase contract to better cover the seller's interests, as contrasted with how the broker “helped” the buyer here. A real estate developer, whose business includes routinely entering into purchase contracts and who undoubtedly had legal counsel relating to the development, is clearly a more sophisticated party than a buyer who may have never before entered into a purchase contract and who apparently did not have the benefit of a lawyer's advice at the time the buyers entered into the contract. Hence, the court misapplied the “stronger party” factor in analyzing the procedural unconscionability claim.<sup>180</sup> Finally, as previously noted, the court did not place adequate weight on the impact of the broker's letter to the buyers which stated the buyers should enter into a contract to lock in the purchase price.<sup>181</sup> The court wrongly concluded that the buyers did not “reasonabl[y]” rely on the letter

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174. *Id.* at \*9, \*11.

175. *See, e.g.,* Port Largo Club, Inc. v. Warren, 476 So. 2d 1330, 1333 (Fla. Dist. Ct. App. 1985).

176. *Goodwin*, 2007 WL 2221066, at \*10-12.

177. *Id.* at \*11-12.

178. *Id.* at \*12.

179. *Id.*

180. *Id.*

181. *Id.* at \*8, \*12.

because the contract contained terms stating that the contract superseded any and all other previous agreements.<sup>182</sup> In another law review article, we demonstrated the unfairness of this type of conclusion in light of the psychological realities of consumers' likely comprehension of contract terms, and basing a fraud or deceptive practices act claim on such a presumption creates a license to deceive.<sup>183</sup> Perhaps the weakest point of the court's analysis of the procedural unconscionability claim was the court's conclusion that there may not have been a conflict between the contract terms and the letter because if the seller had not exercised its right to terminate, the buyers could have purchased the unit for the contracted-for purchase price.<sup>184</sup> If the termination right had been very narrow in scope there might be some validity to this statement. But because the contract clause broadly provided the seller with a right of termination, that right contradicts the lock-in statement promised in the letter.

A final critique of the *Goodwin* decision is whether courts should require evidence of "bad faith"—defined by the court as the seller using the limitation-of-remedy clause to "pick its deal" based on property valuation or better offers—to rule that the type of limitation-of-remedy clause in *Goodwin* is unenforceable.<sup>185</sup> Courts, arguably, should refuse to enforce a limitation of buyer remedies, when the seller is provided very adequate remedies to address their losses, even if the seller is not trying to use the clause to "pick its deal."<sup>186</sup> The buyer will, in a typical deal, suffer a loss of out-of-pocket expenses and, in some cases, loss of expectation damages or consequential damages when the seller fails to close and terminates the contract, regardless of whether the failure to close is in bad faith. Loss of the right to specific performance is a major waiver of a right and, as noted earlier, courts should not enforce when the buyer has waived other remedies, while the seller retains important remedies.

The Washington Supreme Court in *Torgerson v. One Lincoln Tower, LLC*,<sup>187</sup> also ruled that a contract clause clearly limiting the buyer's remedy to return of her own earnest money, while the seller's remedy was retention of the earnest money, was enforceable and not unconscionable.<sup>188</sup> The special and unique facts in *Torgerson*, however, better justify this ruling than in *Goodwin*. In addressing the procedural unconscionability claim, the *Torgerson* court noted that the purchasers were real estate brokers who were marketing the sales of units in the building<sup>189</sup> and that they negotiated for certain changes to the form contract regarding the interior finish, color schemes, and due dates and amount for the

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182. *Id.*

183. Debra Pogrud Stark & Jessica M. Choplin, *A License to Deceive: Enforcing Contractual Myths Despite Psychological Realities*, 5 N.Y.U. J. L. & BUS. 617, 707-10 (2009).

184. *Goodwin*, 2007 WL 2221066, at \*12.

185. *Id.* at \*11.

186. *Id.*

187. 210 P.3d 318 (Wash. 2009) (en banc).

188. *Id.* at 320, 324-25.

189. *Id.* at 323.

earnest money deposit.<sup>190</sup> In addressing the substantive unconscionability claim, the court emphasized the very low security deposit paid by the buyers/brokers and that the buyer would pay the bulk of their security deposit seven days before closing or even at the closing.<sup>191</sup> The court inferred from these facts that these buyers agreed to the extreme limitation of their remedies in exchange for the low initial security deposits and had better opportunities to negotiate the contract than typical home buyers.<sup>192</sup> Although not expressly noted by the court, it would also be fair to infer that these buyers/brokers were far more familiar with the terms of the developer's form contract and more likely to have a sense of the remedies the buyers were giving up. The amount they initially deposited was only \$5000 for each unit.<sup>193</sup> The court assumed, perhaps correctly, that the brokers agreed to the extreme limitation-of-remedy for the seller's breach in exchange for the buyers'/brokers' low initial deposit—\$5000—as earnest money.<sup>194</sup> The normal earnest money deposited to estimate a seller's damages for a buyer's breach is in the range of 5-10% of the purchase price, and here the \$5000 deposit is only 1.5% of the \$332,220 purchase price for one buyer/broker and 0.37% of the \$1,318,000 purchase price for the other buyer/broker.<sup>195</sup> The brokers also, however, pledged the commissions they would have earned at closing as part of their security deposit, thus, respectively increasing the deposits to 5% and 10% of these purchase prices.<sup>196</sup> Assuming that the commissions were only for this deal, although the case is not clear on this point,<sup>197</sup> the court would be correct to point out that the very small amount of money the buyers deposited—the rest of the deposit apparently not being payable until closing of this deal) justified them having very limited remedies upon the seller's default.<sup>198</sup> But if the assignment was of commissions owed to these brokers for other deals, then this was valuable consideration and much more within the normal range (although not being paid up front, as is typical), and there would be a substantial imbalance in remedies.

Notwithstanding the appropriateness of the result in *Torgerson*—i.e., the court was upholding a true bargain made between sophisticated parties—the case

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190. *Id.* Some contracts, those created later, only limited buyers from obtaining consequential damages or punitive damages. *Id.* at 321.

191. *Id.* at 323.

192. *Id.*

193. *Id.* The court does not clarify whether the commission relates to the sale of these two units or other units they acted as brokers on. If it is for other units that they would be owed a commission on, then the earnest money adding up to 5% of the purchase price for one broker/buyer, and 10% for the other broker/buyer, is in fact a significant sum of money, and the argument that there was no substantive unconscionability under the facts of this case is less strong.

194. *Id.*

195. *Id.*

196. *Id.* at 324.

197. The court stated, “[T]he Buyers negotiated to pay the rest of the deposits in commissions from their work as agents for the condominium development, and that money was due only seven days prior to closing or at closing.” *Id.* at 323.

198. *Id.* at 323-24.

has some problematic dicta. First, although the court noted that under Washington law, a clause that unilaterally and severely limits the remedies of one side is substantively unconscionable for denying any meaningful remedy,<sup>199</sup> the court declined to rule on whether the doctrine of unconscionability applies to real estate transactions in the State of Washington.<sup>200</sup> In addition, even when the court analyzed whether the contract remedy clause was unconscionable, its statement—“both sides are limited to the retention or return of deposits in case of breach”<sup>201</sup>—seemed to imply that this was a remedy that was mutually beneficial to the non-breaching party and detrimental to the non-breaching party. The court continued, “To be sure, the deposits come out of Buyers’ pockets; but at \$5,000 the promise of real estate commissions payable upon closing, the deposits are not so insignificant a sum as to foreclose legal action.”<sup>202</sup> It is true that the non-defaulting buyer here will want his \$5000 deposit back, but that is still only a return of the buyer’s own money, as is the return of the commission for work done on other deals. The buyer would be receiving a meaningful remedy here with the return of the commissions he pledged to the seller only if the commission for *this* closing was due to the buyer/broker even upon seller’s breach of this contract.

A second category of dicta that is problematic in the *Torgerson* case relates to its treatment of possible UCC remedies protections. The court stated that just because case law in the state has adopted UCC law on the disclaimer of the warranty of habitability for construction contracts, it does not mean that this court would extend UCC remedy protections to real estate contracts.<sup>203</sup> Nevertheless, the court addressed remedies laws “[u]nder the UCC, indicating that under the UCC, general remedies may be available where ‘circumstances cause an exclusive or limited remedy to fail of its essential purpose.’”<sup>204</sup> The court noted that commentary for this section of the UCC states that parties are free to shape their remedies, and reasonable agreements limiting them are to be given effect.<sup>205</sup> Although the court refused to extend UCC remedial provisions to this real estate transaction, it proceeded to conclude that the remedies clause here would satisfy the UCC test.<sup>206</sup> The court stated, “[s]ince Buyers get their deposits back, along with certain sums paid for improvements on the units, they are not left without ‘a fair quantum of remedy’ as is the concern of the UCC in a goods context.”<sup>207</sup> This interpretation of the UCC remedial provisions is highly problematic since it provides that the grant of only rescission/restitution to the non-breaching party and potentially much greater remedies to the other breaching

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199. *Id.*

200. *Id.* at 324.

201. *Id.* at 323.

202. *Id.*

203. *Id.* at 325.

204. *Id.* (quoting WASH. REV. CODE § 62A.2-719 (2013)).

205. *Id.*

206. *Id.*

207. *Id.* (citation omitted).

party is still “a fair quantum of remedy.”<sup>208</sup> The court failed to limit this dicta to the setting where the other party is also severely limited in its remedies or if the other party who has waived contractual remedy rights has been given other valuable consideration for their waiver.

Finally, the *Torgerson* court’s reasoning in its ruling that the contract remedies clause did not violate public policy is also flawed.<sup>209</sup> The buyer correctly pointed out that limiting the buyer’s sole remedy for the seller’s default to a refund of the buyer’s earnest money, or other sums paid by the buyer, encourages sellers to engage in more strategic defaults, and enforcement of such a clause would therefore “be injurious to the public.”<sup>210</sup> In response, the court stated, “[T]he remedies limitations can cause either these Buyers or Sellers to bear the risk of the other party’s breach, depending on changes in the housing market. . . . [T]his agreed upon allocation of risk, which limits liability for both parties, does not violate public policy.”<sup>211</sup> Again, the court treats the limitation-of-remedies clauses as being comparable, but the buyer would have to experience a loss greater than at least \$5000 plus transactions costs, to benefit from a strategic default, while the seller would only have to lose \$1, plus transaction costs, to benefit from a strategic default.<sup>212</sup>

Courts in Florida have taken a different approach and have embraced the argument that a clause that limits the home purchaser to the remedy of return of the buyer’s earnest money upon seller’s default creates an illusory contract, permitting the seller “to breach with impunity.”<sup>213</sup> Thus, the court in *Port Largo Club, Inc. v. Warren*, held that this type of clause was unenforceable and would permit the buyer to obtain the remedy of specific performance<sup>214</sup> or benefit of the bargain damages,<sup>215</sup> notwithstanding the limitation-of-remedy clause in the contract, when the seller breached the contract. The court stated that “[p]ersons may limit their liability by contract, but such provisions must be reasonable to be enforced.”<sup>216</sup> Because the court noted that this type of clause “renders the seller’s obligation wholly illusory and would permit him to breach with impunity,” the court concluded that “such provisions are antithetical to the concept of fair dealing in the marketplace and will not be enforced by courts of

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208. *Id.*

209. *Id.*

210. *Id.*

211. *Id.* (citation omitted).

212. *Id.* at 323.

213. *See, e.g., Port Largo Club, Inc. v. Warren*, 476 So. 2d 1330, 1333 (Fla. Dist. Ct. App. 1985).

214. The court did not actually award a remedy of specific performance but instead remanded the cause for a new trial to determine damages. *Id.* at 1334.

215. *Id.* at 1333. The buyer did not obtain the benefit of the bargain damages in this case because the buyer failed to provide evidence of the difference between the fair market value of the property on the date of the breach compared with the contract price. *Id.* at 1334.

216. *Id.* at 1333.

law.”<sup>217</sup> The court also stated that to obtain benefit of the bargain damages, the breaching party must have breached in bad faith, which the court initially defined as the opposite of good faith and later seemed to define as being without any “reasonable justification.”<sup>218</sup> The court noted that the time-share units under contract had increased substantially in value, and because the seller failed to provide reasonable justification for the failure to complete the closing, the court deemed this failure to close was lacking good faith.<sup>219</sup>

The Florida Court of Appeals in *Blue Lakes Apartments, Ltd. v. George Gowing, Inc.*,<sup>220</sup> similarly ruled that although parties to a contract may agree to limit their respective remedies and that the remedies still available to each party need not be the same, the “contractual provisions . . . must be reasonable to be enforced.”<sup>221</sup> The court ruled that a contract clause limiting for the buyer’s sole remedy to the return of the buyer’s earnest money, while the seller’s sole remedy is limited to retention of the earnest money, constituted a “heads-I-win, tails-you-lose approach to defaults . . . so rapaciously skewed as to be patently unreasonable.”<sup>222</sup> The court also characterized this type of limitation-of-remedies clause as a subversion of contract that “permit[s] one party to breach with impunity, [causing] the seller’s obligations to become wholly illusory, while the buyers’ are quite real” (the buyer had deposited 10% of the purchase price as its security deposit in this case).<sup>223</sup> The appellate court affirmed the trial court’s award of benefit of the bargain damages and did not require a showing of bad faith.<sup>224</sup> In support of its similar conclusion that this type of limitation-of-remedies clause creates an illusory contract, the Florida court in *Ocean Dunes of Hutchinson Island Development Corp. v. Colangelo*,<sup>225</sup> noted that the “return of one’s own money hardly constitutes damages in any meaningful sense.”<sup>226</sup> The court in *Ocean Dunes* therefore ruled that “the contract provide[d] no reasonable remedy for its breach,” and affirmed the trial court’s ordering the equitable remedy of specific performance for the buyer.<sup>227</sup>

The court in *Idevco, Inc. v. Hobaugh*,<sup>228</sup> also ruled that when the buyer’s sole

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217. *Id.* (quoting *Blue Lakes Apartments, Ltd. v. George Gowing, Inc.*, 464 So. 2d 705 (Fla. Dist. Ct. App. 1985)).

218. *Id.* at 1333-34.

219. *Id.* at 1334.

220. 464 So. 2d 705 (Fla. Dist. Ct. App. 1985).

221. *Id.* at 709.

222. *Id.*

223. *Id.* (internal quotation marks omitted).

224. *Id.* The court did mention that the seller had sold the property to a third party but noted this in the context of answering why the trial court did not award specific performance. *Id.* The court also mentioned the purchase price of the property in a sale to a third party in the context of affirming the trial court’s calculation of benefit of the bargain damages. *Id.*

225. 463 So. 2d 437 (Fla. Dist. Ct. App. 1985).

226. *Id.* at 439.

227. *Id.* at 440.

228. 571 So. 2d 488 (Fla. Dist. Ct. App. 1990).



remedy is return of her earnest money, and the seller's sole remedy is retention of the buyer's earnest money, there is a lack of mutuality of obligation, and the limitation-of-remedies clause was therefore void.<sup>229</sup> However, in *Idevco*, it was the buyer who was in breach of contract—not the seller.<sup>230</sup> Consequently, the court affirmed the trial court's order that the seller return the buyer's earnest money deposit, but noted that “when a default provision of a purchase agreement is invalid . . . the nondefaulting [party (here the seller)] is entitled to prove and recover actual damages.”<sup>231</sup> The court in *Hackett v. J.R.L. Development, Inc.*<sup>232</sup> also ruled that the buyer in default would not lose his earnest money under a similar contract remedies limitation clause because the clause was invalid for lack of mutuality of obligation.<sup>233</sup> The seller could still recover its actual damages from the breach by properly pleading and proving actual damages.<sup>234</sup> The trial court concluded that the remedy was reasonable because the buyer would also be entitled, under other portions of the contract, to the interest generated from the security deposit in the event of the seller's default (similar to the Utah District court's ruling in *Goodwin*).<sup>235</sup> The appellate court disagreed because “[t]he interest [wa]s earned on the buyers' money; thus, the seller ha[d] no real obligation.”<sup>236</sup> The court in *Terraces of Boca Associates v. Gladstein*<sup>237</sup> also ruled that a similar contract limitation-of-remedies clause was invalid and unenforceable due to the “unreasonable disparity in remedy alternatives available to [the] seller and buyers,” and, therefore, the buyers in breach were entitled to the return of their deposit.<sup>238</sup> The court did not address whether a seller could recover actual damages when a buyer is in breach, but the contract remedies clause invalidly attempts to grant to the seller the option to return the earnest money or sue instead for actual damages.<sup>239</sup>

In light of these Florida cases, it appears that a clause limiting the buyer's sole remedy to return of its earnest money but allowing the seller the remedy of retention of the buyer's earnest money, will not be enforced under Florida law.

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229. *Id.* at 489-90.

230. *Id.* at 490.

231. *Id.*

232. 566 So. 2d 601 (Fla. Dist. Ct. App. 1990).

233. *Id.* at 603.

234. *Id.*

235. *Id.*

236. *Id.*

237. 543 So. 2d 1303 (Fla. Dist. Ct. App. 1989).

238. *Id.* at 1304. The limitation-of-remedies clause in this case was even more unfair than the paradigm clause since the remedies limitation not only limited the buyers' sole remedy to return of its earnest money, it also granted the seller the right to choose between retaining the earnest money as liquidated damages or pursuing actual damages or equitable remedies, which is considered an invalid option in some states, causing the seller to forfeit the right to make the election. *Id.* at 1303.

239. *Id.*; see also *Catholic Charities of the Archdiocese of Chi. v. Thorpe*, 741 N.E.2d 651, 657-58 (Ill. App. Ct. 2000); *Grossinger Motorcorp, Inc. v. Am. Nat'l Bank & Trust Co.*, 607 N.E.2d 1337, 1346 (Ill. App. Ct. 1993).

However, there are two Florida cases that may have taken a less protective approach. The court in *Greenstein v. Greenbrook, Ltd.*<sup>240</sup> enforced a limitation-of-remedies clause that prohibited both parties from bringing a claim of specific performance for the other party's breach, ruling that it was mutual and reasonable.<sup>241</sup> Although the court focused on the portion of the remedies clause that provided for the mutual agreement relating to specific performance, the clause also stated that the buyer's "full and complete settlement of all claims against Seller" in the event of the seller's default was "a full refund of all monies . . . paid to Seller" by the buyer.<sup>242</sup> Further, the seller's remedy was retaining the monies paid by the buyer as liquidated damages.<sup>243</sup> The court failed to address this fact except in a footnote where it stated that it had "not decided whether [the buyer] in an action for damages upon Seller's default, would be limited to the return of his deposit, where Seller's default was shown to be in bad faith."<sup>244</sup> However, the court then cited a prior Florida case that allowed recovery beyond the return of the buyer's earnest money when there was a finding of bad faith on the seller's part.<sup>245</sup> Although unclear, this court may have indicated it would enforce this type of limitation of liability clause except upon a showing of bad faith. Indeed, in the *Port Largo Club* case, in the same district, the court ruled three years later that in order to obtain benefit of the bargain damages, there must be a showing of bad faith.<sup>246</sup>

The second Florida case with a less protective approach was *Developers of Solamar, LLC v. Weinbauer*.<sup>247</sup> The contract in *Solamar* included an exception to the limitation of the buyer's remedies in the event of the seller's willful breach of the contract.<sup>248</sup> In light of this, the court concluded that this default clause did not "fail for lack of mutuality" of obligation in that the buyer could seek his actual damages if the seller had willfully failed to perform.<sup>249</sup> "As such, [the seller] could not have breached the terms of the contract 'with impunity.'"<sup>250</sup> While this is accurate, an argument could still be made, as raised earlier, that whether the seller breached for a cause beyond its control or with impunity, the buyer's losses exist in both situations. Thus, if the seller has reserved more meaningful remedies for a buyer default, a court might find that the buyer's lack of remedy creates an unreasonable limitation of liability or unconscionable due to the imbalanced contractual rights among the parties.

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240. 413 So. 2d 842 (Fla. Dist. Ct. App. 1982).

241. *Id.* at 843-44.

242. *Id.* at 843 n.1.

243. *Id.* at 843-44 & 843 n.1.

244. *Id.* at 844 n.4.

245. *Id.*; see also *Sperling v. Davie*, 41 So. 2d 318 (Fla. 1949).

246. *Greenstein*, 413 So. 2d at 844 n.4; *Port Largo Club, Inc. v. Warren*, 476 So. 2d 1330, 1333-34 (Fla. Dist. Ct. App. 1985).

247. 18 So. 3d 13 (Fla. Dist. Ct. App. 2009).

248. *Id.* at 15.

249. *Id.* at 16.

250. *Id.* (quoting *Hackett v. J.R.L. Dev., Inc.*, 566 So. 2d 601, 603 (Fla. Dist. Ct. App. 1990)).

It should be noted that other states have also embraced the concept that an illusory promise can render a contract or clause in a contract to be unenforceable, albeit in different factual contexts.<sup>251</sup> The court in *Reeves v. Memorial Terrace, Ltd.*<sup>252</sup> addressed illusory promises involving a contract with terms that made the buyer's promise to purchase land illusory.<sup>253</sup> In *Reeves*, the court noted that for a contract to be enforceable, it "must be supported by valid consideration, *i.e.*, mutuality of obligation," which "can consist of an exchange of promises."<sup>254</sup>

However, if a promise fails to actually bind a party because he retains the option to terminate the transaction in lieu of performing it, then the promise is illusory and is not valid consideration. Therefore, when illusory promises are all that support a purported bilateral contract, there is no contract.<sup>255</sup>

Although there is no direct power to terminate the agreement at any time in our paradigm situation, this Article argues that when the sale remedy upon breach is merely the refund of the buyer's earnest money, the seller has created a power to terminate the agreement at any time, thereby making the seller's promises of performance illusory.

In summary, Florida, more than other states, protects home buyers from grossly unfair limitation-of-remedies clauses for two reasons. The first is the different legal standard Florida applies to limitation-of-liability clauses than other jurisdictions. Florida courts will not enforce limitation-of-remedies clauses when they are shown to be "unreasonable," while other courts require the much higher standard of "unconscionable" for such clauses to be unenforceable.<sup>256</sup> Second, Florida courts better recognize the "non-remedy" nature of the "remedy" of returning to the non-breaching party its own money and find contracts that provide this as the sole remedy to be illusory in nature.<sup>257</sup> This thereby permits the courts to refrain from enforcing the clause. Viewing such clauses as creating an illusory agreement has also enabled Florida courts to refrain from enforcing the clause when the buyer has breached and also to relegate the seller to a remedy

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251. See generally RESTATEMENT (SECOND) OF CONTRACTS § 77 cmt. a (1981) ("*Illusory promises*. Words of promise which by their terms make performance entirely optional with the 'promisor' do not constitute a promise."). See *id.* illus. 2 ("A promises B to act as B's agent for three years from a future date on certain terms; B agrees that A may so act, but reserves the power to terminate the agreement at any time. B's agreement is not consideration, since it involves no promise by him.").

252. *Reeves v. Memorial Terrace, Ltd.*, No. 14-02-0633-CV, 2004 WL 2933807 (Tex. App. Ct. Dec. 21, 2004).

253. *Id.* at \*1-2.

254. *Id.* at \*1.

255. *Id.* (internal citation omitted).

256. See, e.g., *Goodwin v. Hole No. 4, LLC*, No. 2:06-cv-00679, 2007 WL 2221066, at \*10-12 (D. Utah July 31, 2007); *Port Largo Club, Inc. v. Warren*, 476 So. 2d 1330, 1333 (Fla. Dist. Ct. App. 1985).

257. *Warren*, 476 So. 2d at 1333.

of actual damages rather than liquidated damages when the liquidated damages amount was higher.<sup>258</sup>

In light of the results from the two empirical studies described in Part I and the Remedies Experiment detailed in Part II, the approach of requiring that limitation-of-remedies clauses be reasonable in order to be enforceable makes much more sense than the approach of applying the very difficult to meet unconscionability test. The unconscionability test makes sense when there has been a true bargain between parties who understood the terms of the contract. When this has not occurred, courts still engage in this fiction of analyzing unconscionability in order to further the goal of creating certainty of contracts and to encourage parties to refrain from entering into contracts when they do not understand what they are agreeing to.<sup>259</sup> But in light of the widespread use of highly unfair limitation-of-remedies clauses evidenced in the two empirical studies, the likely lack of bargaining over such clauses in light of the profound lack of consumer understanding of them, as evidenced in the Remedies Experiment (with participants being overly optimistic that they still had remedies available to them notwithstanding clear language to the contrary—clear at least to a lawyer),<sup>260</sup> it is imperative that courts take this reality into account and apply the Florida approach or other protective approaches described in Part IV.

#### IV. LEGAL REFORMS TO ADDRESS THE PROBLEM OF DYSFUNCTIONAL CONTRACTS

This Article proposes four law reforms to reduce the problem of “dysfunctional contracts.”<sup>261</sup>

##### *A. Modify the Unauthorized Practice of Law Rules*

Entering into a contract to purchase a home is the single largest and most important transaction that most consumers will enter into,<sup>262</sup> and such contracts typically cover, in a highly technical fashion, a myriad of legal issues that can arise both before and after the closing.<sup>263</sup> Yet many states do not require an attorney to represent homebuyers for the purpose of reviewing and proposing

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258. See, e.g., *Hackett v. J.R.L. Dev., Inc.*, 566 So. 2d 601 (Fla. Dist. Ct. App. 1990); *Idevco, Inc. v. Hobaugh*, 571 So. 2d 488 (Fla. Dist. Ct. App. 1990).

259. See, e.g., *Morales v. Sun Contractors, Inc.*, 541 F.3d 218, 221-23 (3d Cir. 2008); *Shelton v. Ritz Carlton Hotel Co.*, 550 F. Supp. 2d 74, 80-81 (D.D.C. 2008).

260. Remedies Experiment, *supra* note 8.

261. By “dysfunctional contracts” we mean contracts where the professional seller’s form limits the seller’s liability for its breach of the contract to return of the buyer’s earnest money and reserves to the seller far more significant rights in the event of the buyer’s default, such as retention of this earnest money.

262. See *Braunstein & Genn*, *supra* note 10, at 470 n.4 (stating that 132 of the homebuyers surveyed in the Columbus area “said that their house was the most valuable asset they owned”).

263. Debra Poggrund Stark, *Navigating Residential Attorney Approvals: Finding a Better Judicial North Star*, 39 J. MARSHALL L. REV. 171, 178-85 (2006).

changes to the form contract to protect the buyer's expectations and goals,<sup>264</sup> as is more commonly done in Illinois and a few other states.<sup>265</sup> One important reason<sup>266</sup> for the prevailing practice of home buyers' reliance on brokers for assistance, rather than lawyers, is that, in many states, the rules on the unauthorized practice of law permit brokers to fill in standard form purchase and sale contracts without the assistance of an attorney.<sup>267</sup> It is thus customary for

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264. See *infra* note 267 and accompanying text for examples of states that permit brokers to fill in form purchase contracts. When brokers are permitted to fill in form purchase contracts—a task which is arguably incident to their role in helping to bring the buyer and seller together—it is in the broker's interest to not have an attorney review and approve the contract because the attorney may raise points that delay the deal or even cause the deal to not go through. Consequently, brokers are not likely to encourage the buyer to hire an attorney at this stage, unless the brokers would incur liability for failing to do so. Based on data collected in an empirical study in Columbus, Ohio 59% of homebuyers interviewed indicated that they did not hire an attorney to represent them. Braunstein & Genn, *supra* note 10, at 471.

265. See Stark, *supra* note 263, at 188 n.39 (noting eleven states where there is case law on the use of attorney approval clauses in residential deals).

266. Another important reason is that some attorneys fail to properly review the purchase agreement with the buyer as they should, causing home buyers to justifiably not see any value in spending the money to hire an attorney. The homebuyers in the empirical study in Columbus, Ohio, provided two main reasons for choosing not to hire an attorney: (i) the costs for the attorney (with some expressing it would be “a waste of money”) and (ii) because “other person[s] in the transaction performed the role of, or obviated the need for, a lawyer.” Braunstein & Genn, *supra* note 10, at 472.

267. See *Conway-Bogue Realty Inv. Co. v. Denver Bar Ass'n*, 312 P.2d 998, 401-02, 421-22 (Colo. 1957) (en banc) (holding it would be “unrealistic and impractical” for lawyers to have to complete all real estate sales transactions); *Pope Cnty. Bar Ass'n v. Suggs*, 624 S.W.2d 828, 830-31 (Ark. 1981) (holding that the preparation of real estate purchase contracts are so “indigenous to the practice of law that it would be illogical to say they are not. But we can also say, as a majority of other jurisdictions have done, that it is in the public interest to permit the limited, outside use of standard, printed forms in the manner stipulated by the chancellor and we so hold.”); *The Fla. Bar v. Irizarry*, 268 So. 2d 377, 379 (Fla. 1972) (“[W]e have limited the permissible scope of activities of real estate brokers to preliminary negotiations and preparation of the contract.”); *Cardinal v. Merrill Lynch Realty/Burnet, Inc.*, 433 N.W.2d 864, 866-67 (Minn. 1988) (“The provisions of [the Minnesota statute] shall not prohibit . . . any one, acting as broker for the parties or agent of one the parties to a sale . . . of . . . property . . . from drawing or assisting in drawing, with or without charge, papers incident to the sale.”); *Hulse v. Criger*, 247 S.W.2d 855, 861 (Mo. 1952) (“[W]hen acting as broker, a realtor may use an earnest money contract form for the protection of either party against unreasonable withdrawal from the transaction, provided that such earnest money contract form, as well as any other standard legal forms used by the broker in transacting such business, shall first have been approved and promulgated for such use by the bar association and the real estate board in the locality where the forms are to be used.”); *Calvert v. K. Hovnanian at Galloway, VI, Inc.*, 607 A.2d 156, 160 (N.J. 1992) (“The Bar Association and the Association of Realtors finally agreed to a settlement that permitted licensed realtors receiving commissions for the sale of residential real estate to prepare the contracts for those sales provided that each contract contain a

real estate brokers to use the standard form contract prepared by the developer, fill in the blanks of the form contract, such as the purchase price, loan numbers, and closing date, but not provide legal advice on the contract.<sup>268</sup> Some courts have permitted this due to a failure to appreciate the important rights that can be eradicated through a contract that a well-trained attorney would identify and address but a broker would not.<sup>269</sup> But some courts, such as the Supreme Court of New Jersey, have expressed an appreciation for the important rights and obligations that a real estate purchase agreement creates but concluded that, since there is no evidence of how the public is, in fact, harmed when not represented by an attorney,<sup>270</sup> the court would not prevent brokers from assisting home buyers

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clause making the contract subject to review by an attorney for the buyer or seller at either party's option within three business days after execution."); *In re Duncan & Hill Realty, Inc. v. Dep't of State*, 62 A.D.2d 690, 696 (N.Y. App. Div. 1978) ("As long as real estate brokers and agents have not held themselves out to be attorneys at law, have confined their actions to serving their clients in relation to the specific transaction (such as drawing a contract of sale) in which the broker has a financial interest for payment of his services, and have made no charge for these incidental services, such acts have been held by our courts to be proper and not to constitute the unlawful practice of law."); *Or. State Bar v. Sec. Escrows, Inc.*, 377 P.2d 334, 340 (Or. 1962) (finding that an exception from the injunction is "the filling-in of blanks under the direction of a customer upon a form or forms selected by a customer. If the customer does not know what forms to use or how to direct their completion, then he needs legal advice. If the customer does know what he wants and how he wants it done, he needs only a scribe"); *see also* *Creditors' Serv. Corp. v. Cummings*, 190 A. 2, 12-13 (R.I. 1937); *Bar Ass'n of Tenn., Inc. v. Union Planters Title Guar. Co.*, 326 S.W.2d 767, 779 (Tenn. Ct. App. 1959); *Perkins v. CTX Mortgage Co.*, 969 P.2d 93, 99 (Wash. 1999) (en banc).

268. *See, e.g.*, *Pope Cnty. Bar Ass'n v. Suggs*, 624 S.W.2d 828, 829 (Ark. 1981) ("[T]he broker shall not give advice or opinions as to the legal rights of the parties, as to the legal effects of instruments to accomplish specific purposes or as to the validity of title to real estate."); *State ex rel. Wright v. Barlow*, 268 N.W. 95, 96 (Neb. 1936) (permitting a non-lawyer to draft documents—acting "merely as an amanuensis"—but who does not provide advice "or counsel as to the legal effect and validity of [legal] instruments").

269. *See* *Chi. Bar Ass'n v. Quinlan & Tyson, Inc.*, 214 N.E.2d 771, 773-74 (Ill. 1966) (distinguishing filling in blanks on a deed or other documents that "affect titles to real estate [which] have many points to consider" with filling in blanks ("such as the date, price, name of the purchaser, location of the property, date of giving possession and duration of the offer") or making "appropriate deletions . . . to conform to the facts" in a purchase and sale contract that "is customarily used in the community" since such services "require no more than ordinary business intelligence [sic] and do not require the skill peculiar to one trained and experienced in the law"). It is hard to understand why the court understood how "the mere filling in of the blanks" can be more complicated than it appears in a deed affecting title, but not in a contract form that affects the parties rights and obligations between each other. *Id.* at 774.

270. *See In re Opinion No. 26 of the Comm.*, 654 A.2d 1344, 1345-46, 1359 (N.J. 1995) (per curiam). The court also noted the cost savings to the homebuyer when the broker fills in the form contract as contrasted with the buyer paying to have an attorney do so. *Id.* at 1360.

in the use of a form purchase contract.<sup>271</sup> Two prior studies, one by a special master at the direction of the Supreme Court of New Jersey,<sup>272</sup> and the other by Professor Joyce Palomar, who focused on the impact of an attorney at the conveyance stage rather than at the contracting stage,<sup>273</sup> failed to show how having non-attorneys assist buyers in their home purchase transactions negatively impacts the public. These studies and the lack of a showing of public harm has led, in part, to the Federal Trade Commission and the Department of Justice taking the position that allowing laypersons to perform tasks involved in residential real estate transactions is unlikely to increase the risk of harm for consumers and should be permitted.<sup>274</sup> Consequently, the results from the Remedies Experiment<sup>275</sup> and the Condo Contracts Study<sup>276</sup> are important contributions for the question of public harm and the rules relating to the unauthorized practice of law.

Based on the results from the Remedies Experiment, it is clear that most consumers, even if they carefully read the limitation-of-remedies clause in the contracts presented to them, will not understand what rights they have waived<sup>277</sup> and will not know to bargain for revision of the clause or to bargain to add an attorneys' fees clause to the contract. One way to address this major problem is to change the unauthorized practice of law ("UPL") rules to prohibit brokers from filling in the blanks of a purchase and sale agreement, which should lead more buyers to seek out an attorney to assist them with this task. State law could require these forms to state at the top that "this legal document will have a major impact on the buyer's rights and obligations," and "the buyer should consult with an attorney before signing the agreement." States could go even further and require that prospective home buyers hire an attorney to review and advise them on the purchase and sale agreement before the buyer can be bound by the agreement (such as requiring an attorney review/approval clause). In light of the results from our Attorney Survey, which reflects, among other things, that in 1-10% of the deals a major dispute arises between the parties after the contract is signed and that the contract language is likely to have an essential impact on the rights and obligations of the parties relevant to this dispute, empirical evidence

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271. *Id.* at 1361-62. Furthermore, when attorneys fail to spot problems with how a transaction is structured and documented and fail to negotiate for changes to reduce these problems, or fail to inform their client of these problems, their clients justifiably see no added value in hiring an attorney and only see the added costs in doing so.

272. *In re Opinion No. 26 of the Comm.*, 654 A.2d at 1351.

273. Joyce Palomar, *The War Between Attorneys and Lay Conveyancers—Empirical Evidence Says "Cease Fire!"*, 31 CONN. L. REV. 423, 520 (1999).

274. Ann M. Burkhart, *Real Estate Practice in the Twenty-First Century*, 72 MO. L. REV. 1031, 1062-66 (2007).

275. See Remedies Experiment, *supra* note 8. See *infra* Part II.B.

276. See Condo Contracts Study, *supra* note 1.

277. Remedies Experiment, *supra* note 8. Indeed, as noted in Part II, many participants appear not to recognize the possibility of recovering benefit of the bargain/expectation damages or consequential damages and expressed skepticism that this is a recoverable loss. *Id.*

now supports the proposition that homebuyers clearly are harmed when not represented by a well-trained attorney.<sup>278</sup> We therefore propose a companion rule to the change in the UPL laws that would mandate use of an attorney by a home purchaser. The UPL rules should also require that only attorneys who have undergone special training and additional licensing for this type of representation can represent buyers of homes related to this area of practice. This would better ensure that home purchasers receive real value if they are required to hire an attorney to protect their interests.

*B. Enact Legislation That Prohibits Remedies Clauses That Limit Buyers' Remedies to Return of Earnest Money and Create Safe Harbor Rules Based on Mutuality of Remedy and True Bargaining*

Unfortunately, even if assisted by very able counsel, such attorneys might not be successful in negotiating for revisions to the typical limitation-of-remedies clauses used by developers, especially if it happens to be a seller's market.<sup>279</sup> Thus, even with a reform of the UPL rules, state legislators should consider legislation that prohibits the one-sided type remedy clauses focused on in this Article. The question then arises of what would be an acceptable limitation-of-remedies clause under the statute, i.e., examples of "safe harbors." For example, is it adequate protection to enforce limitation-of-remedies clauses but create a "bad faith" exception to enforcement when the developer is breaching to take advantage of property appreciation? We do not think so for reasons articulated earlier. What if the limitation-of-remedies clause awards the buyer her out-of-pocket expenses, but at a very low or nominal figure? Should that be enforceable? It is difficult to anticipate and address each possible scenario that can arise and a goal, other than protecting buyers, is to create rules that are both clear in scope and permit true bargaining to occur. To accomplish this, laws could create safe harbors based upon the concept of mutuality—meaning if the remedies clause is truly mutual then it would be considered a safe harbor. An example would be mutual liquidating damages clauses (seller retains 5% of the purchase price if buyer breaches, and buyer is entitled to 5% of the purchase price if seller breaches), or mutual rights to specific performance, provided the seller can provide marketable title, or reserving to both parties all rights and remedies available at law or in equity. We advocate creating legislation that prohibits the type of limitation-of-remedies clause focused on in this Article—where the buyer's sole remedy is return of the buyer's earnest money, even with interest on it—but also creates safe harbors based on specific examples of acceptable mutual remedies. A court would judge the enforceability of any limitation-of-remedies clause that does not fit within the parameters of what is expressly prohibited or expressly permitted as a safe harbor under a test that

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278. Attorney Survey, *supra* note 20.

279. *See id.* Only 35% of the attorneys in the Attorney Survey rated themselves as successful in negotiating highly problematic or highly unfair terms in a professional seller's purchase contract form greater than 50% of the time.



determines the reasonableness of the limitation-of-remedies clause under the circumstances (the Florida approach). Major factors in this determination could be whether the buyer truly bargained over the clause, whether the buyer had an attorney representing her, and whether the buyer had a true choice between accepting a limitation-of-remedies that is not mutual in exchange for other valuable consideration (such as a reduction in the purchase price) or the right to decline this other valuable consideration and enjoy a mutual limitation-of-remedies clause instead.

*C. Replace Substantive Unconscionability Test With a “Reasonable Limitation of Remedy” Test in the Home Purchase Context*

Although legislation is preferable to pure judicial response to the problem of dysfunctional contracts because of legislation’s ability to more clearly and comprehensively address the problem than the judiciary, courts need to better protect home purchasers from highly unfair limitation-of-remedies clauses if legislatures fail to enact protections. Courts should replace the near impossible to meet test of substantive unconscionability with the test of whether the limitation-of-remedies clause, under the circumstances, is “reasonable.” Courts could look to factors such as mutuality and true bargaining, articulated above, in determining whether the clause is reasonable. All courts already engage in a test of reasonableness in enforcing liquidated damages clauses, so applying a reasonableness test in the context of limitations of remedies would not be unprecedented, as Florida courts already apply this approach to limitation-of-remedies clauses.

*D. Enact Legislation Requiring Attorney’s Fees to the Buyer When She Is the Prevailing Party in Enforcing Her Rights in the Context of a Home Purchase Agreement*

The reform of requiring attorneys’ fees to the buyer when the prevailing party in a lawsuit to enforce the home purchase agreement is critical because without it, even if the home buyer would have a valid claim for meaningful damages against a breaching seller, the buyer will unlikely be able to afford litigating the claim. This is because the costs of proving one’s case in litigation are typically very high.<sup>280</sup> As noted in Part II, 71% of the participants in the clearly unfair condition and 76% in the *vaguely unfair* condition mistakenly believed there were no laws of remedies that would prevent their recovering of attorneys’ fees for handling the litigation to enforce the contract.<sup>281</sup> They did not realize that this right must be in the contract or in a statute for them to recover. Yet, as noted in Part I, only 14% of the contracts in the Condo Contracts Study contained an attorneys’ fees provision to the prevailing party in the event of a lawsuit to enforce the agreement.<sup>282</sup> This Article also recommends enacting

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280. See O’CONNELL, *supra* note 17.

281. Remedies Experiment, *supra* note 8.

282. Condo Contracts Study, *supra* note 1.

legislation that would prohibit the developer/seller from being able to recover attorney's fees as a result from defending a lawsuit brought by the buyer, unless the court rules the buyer's suit to be frivolous; prior research reflects that fewer consumers will bring meritorious claims if their contract contains a provision permitting the recovery of attorney's fees to the prevailing party.<sup>283</sup> In light of the foregoing, states should enact legislation to require that this type of clause be added to the form purchase agreements to ensure that all buyers will have this right and will realize they have this right if a dispute arises.

### CONCLUSION

The results from the Condo Contract Study reflect that the vast majority of form contracts used by condominium developers in the jurisdiction examined contain a limitation-of-remedies clause that is completely one-sided, patently unreasonable, and that causes the seller's obligations under the contract to be illusory in nature unless "saved" with an implied "bad faith" exception.<sup>284</sup> Yet based on a review of relevant case law, it appears that many courts will still enforce this type of clause when it is clearly provided for and, therefore, presumably bargained for.<sup>285</sup> But in order to bargain for a contract term, one must at least understand it. Consequently, this Article examined how well laypersons in fact understand this prevalent type of limitation-of-remedies clause by assigning one group to a *fair* remedies clause condition (where both parties have reserved all rights and remedies under the law in the event of a breach), a second group to a *clearly unfair* remedies clause (where the buyer's sole remedy in the event of seller's breach is return of the buyer's own earnest money and the seller's remedy, in the event of the buyer's breach, is retention of that earnest money), and a third group to a *vaguely unfair* remedies clause (where the buyer's sole remedy is limited to return of buyer's earnest money but the clause does not expressly state this occurs in the case of the seller's breach). The results of this Remedies Experiment reflected a profound misunderstanding of the impact of the two *unfair* remedies clauses with, for example, 64% in the *clearly unfair* condition and 68% in the *vaguely unfair* condition mistakenly believing they could still seek specific performance if the seller breached the contract, and 54% in the *clearly unfair* condition and 60% in the *vaguely unfair* condition mistakenly believing that they could recover certain out-of-pocket expenses in the event of the seller's breach. These results, and the others detailed in Part II, demonstrate that courts truly engage in a fiction when they presume that consumers understand clearly worded limitation-of-remedies clauses (clear at least to attorneys and judges) and, therefore, conclude that the judiciary should enforce these clauses because they have been bargained for. In light of this reality, we argue that home purchasers need greater protections than they

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283. Debra Pogrud Stark & Jessica M. Choplin, *Does Fraud Pay? An Empirical Analysis of Attorneys Fees Provisions in Consumer Fraud Statutes*, 56 CLEV. ST. L. REV. 483, 508-09 (2008).

284. See *supra* Part III for a discussion of case law.

285. *Id.*

currently enjoy and identify four areas of legal reform to better protect such home purchasers: (i) revise the unauthorized practice of law rules to mandate attorney review and approval of home purchase contracts, further requiring such attorneys to be specially trained and licensed for this type of representation, (ii) enact legislation that prohibits remedies clauses that limit buyers' remedies to return of earnest money and create safe harbor rules based on mutuality of remedy and true bargaining in the home purchase contract, (iii) replace the substantive unconscionability test with a "reasonable limitation of remedy" test in the home purchase context for limitation-of-remedies clauses, and (iv) enact legislation requiring attorneys' fees to the buyer when the prevailing party in the context of enforcing rights in a home purchase agreement.