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OTTEN JOHNSON ALERT

Enforceability of Liquidated Damages Provisions in Colorado

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Liquidated damages clauses frequently appear in commercial contracts, particularly those involving the purchase and sale of real estate. These clauses bring predictability to potential disputes, thereby helping parties manage potential exposure and to reduce potential litigation costs related to proving actual damages at trial.

In order to be enforceable under Colorado law liquidated damages provisions must satisfy the following three elements: (1) the parties intended to liquidate damages; (2) when the contract was made, the amount of liquidated damages was a reasonable estimate of presumed actual damages; and (3) at the time of contract, it was difficult to ascertain the amount of actual damages that would result from a breach.

Most often, disputes related to liquidated damages clauses center on the second element – whether at the time of entering into the contract the amount of liquidated damages was a reasonable estimate of presumed actual damages. This is because liquidated damages are intended to compensate a party for actual loss; not to serve as a penalty. Contracting parties must, therefore, be careful to negotiate liquidated damages amounts that reasonably reflect anticipated losses from a potential breach, rather than pushing for the largest number possible.

However, a recent Colorado Court of Appeals decision, *Ravenstar LLC v. One Ski Hill Place LLC*, addressed the first element in the liquidated damages analysis. The case concerned a liquidated damages clause that gave the parties the option to choose between liquidated and actual damages. The plaintiffs argued that this option negated the required intent to liquidate damages, thereby invalidating the liquidated damages clause. The Court of Appeals disagreed with the plaintiffs position and concluded that a liquidated damages clause does not necessarily bar other remedies, and a contractual option to pursue such other remedies does not negate the parties' intent to liquidate damages or invalidate the liquidated damages clause.

Contracting parties should keep the *Ravenstar* decision in mind when negotiating liquidated damages provisions. If the intent of the parties is to agree upon and limit each party's potential exposure, then the liquidated damages clause should be drafted as an exclusive remedy. However, if the intent is to maximize each party's potential recovery in the event of a breach, then the liquidated damages clause should be drafted to expressly permit the parties to pursue an action for actual damages, which may turn out to be greater than originally anticipated.

It is important to note that the law on liquidated damages varies from state to state. Liquidated damages clauses that are enforceable under Colorado law may be found unenforceable in other jurisdictions. Therefore, choice of law provisions should also be considered in connection with any liquidated damages analysis.

Otten Johnson attorneys have substantial experience helping clients negotiate and enforce liquidated damages provisions. For more information on this Client Alert or for help evaluating your current situation, contact one of our attorneys. [For a listing, please click here.](#)

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950 Seventeenth Street, Suite 1600, Denver, CO 80202
Phone 303.825.8400 | Fax 303.825.6525 | ottenjohnson.com

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