1977

Liquidated Damages: A Comparison of the Common Law and the Uniform Commercial Code

William S. Harwood

Follow this and additional works at: https://ir.lawnet.fordham.edu/flr

Part of the Law Commons

Recommended Citation
Available at: https://ir.lawnet.fordham.edu/flr/vol45/iss7/3

This Article is brought to you for free and open access by FLASH: The Fordham Law Archive of Scholarship and History. It has been accepted for inclusion in Fordham Law Review by an authorized editor of FLASH: The Fordham Law Archive of Scholarship and History. For more information, please contact tmelnick@law.fordham.edu.
COMMENTS

LIQUIDATED DAMAGES:

A COMPARISON
OF THE COMMON LAW
AND THE UNIFORM COMMERCIAL CODE

I. INTRODUCTION

Liquidated damages is an area of the law which seems to mystify many legal scholars. In 1854 a New York Court of Appeals judge remarked that even the "ablest judges have declared that they felt themselves embarrassed in ascertaining the principle on which the decisions . . . were founded." This comment has remained strikingly valid. Simply stated, the courts continue to apply vague and confusing principles in the area of liquidated damages.

Historically, this area of the law developed from Equity which granted relief against the harshness of penal bonds. A penal bond was a form of assurance whereby an individual would bind himself to pay a definite sum of money in the event he failed to perform another primary obligation. The equitable principle granting relief against such bonds later was adopted by courts of law and remains today as the foundation for the rule that penalties are void and unenforceable. However, courts later began to realize that, in certain situations where the actual damages could not be readily ascertained, promises to pay a stipulated sum in the event of a breach of contract were a valid alternative to the uncertainty of a jury's award. This distinction formed the basis for the differentiation between penalties and liquidated damages clauses.

2. "It is not to be denied that there is some conflict, and more confusion, in the cases, judges have been long and constantly complaining of the confusion and want of harmony in the decisions upon this subject." Jaquith v. Hudson, 5 Mich. 123, 132 (1858).
3. "Many more complex and intrinsically less tractable subjects have been reduced to order, this one, from the struggles of the English judges with it before the Revolution to the present time, remains oddly elusive." Callanan Road Improvement Co. v. Colonial S. & S. Co., 190 Misc. 418, 419, 72 N.Y.S.2d 194, 196 (Sup. Ct. 1947).
4. "[N]o branch of the law is involved in more obscurity by contradictory decisions than whether a sum specified in an agreement to secure performance will be treated as liquidated damages or a penalty . . . ." Giesecke v. Cullerton, 280 Ill. 510, 513, 117 N.E. 777, 778 (1917).

4. McCormick, supra note 3, § 147, at 602.

1349
A penalty is a provision in a contract which "is designed to deter a party from breaching his contract" by requiring the payment of a stipulated sum in the event of such a breach. A penalty is said to operate in terrorem. Such a provision is void and a party seeking to enforce it may only recover his actual damages. On the other hand, a provision which is designed "to estimate in advance the actual damage which would probably ensue from the breach [of a contract]" will be enforced as a liquidated damages clause. Once a provision is found to be a valid liquidated damages clause, the party seeking compensation is limited to the stipulated amount regardless of whether this sum is more or less than the actual damages suffered.

The courts have struggled to develop precise rules to differentiate between penalties and liquidated damages clauses. Although these attempts have resulted in conflict and confusion, certain criteria have emerged by which a liquidated damages clause may be distinguished from a penalty.

The first criterion, and generally the most important, listed by courts and commentators is that the "sum stipulated must be a reasonable pre-estimate of the probable loss." Any clause which contains a stipulated sum which is unreasonable in light of the probable loss to be sustained in the event of a breach will be void as a penalty. The reasonableness is to be judged at the time of the formation of the contract rather than at the time of the breach.

A second requirement frequently cited by the courts is that the harm caused by the breach be "incapable or very difficult of accurate estimation." This

5. Calamari & Perillo, supra note 3, § 232, at 367. See also Sweet, Liquidated Damages in California, 60 Calif. L. Rev. 84, 92 (1972) [hereinafter cited as Sweet].
7. It should be noted that penalties usually refer to provisions with an unreasonably large stipulated sum. However, when the sum is unreasonably small the provision will also be denied enforcement. Calamari & Perillo, supra note 3, § 232, at 367-68 n.52; Dobbs, supra note 6, § 12.5, at 822.
8. McCormick, supra note 3, § 146, at 599.
10. Calamari & Perillo, supra note 3, § 232, at 368; McCormick, supra note 3, § 150; Crowley, supra note 9, at 63; Sweet, supra note 5, at 131.
11. The only time in which the actual loss, as opposed to the probable loss viewed at the time the contract was formed, becomes determinative is in those jurisdictions which deny enforcement of a liquidated damages clause when there is no actual loss. Calamari & Perillo, supra note 3, § 232 at 368; Restatement of Contracts § 339, comment (e) at 553-54 (1932). But see United States v. Bethlehem Steel Co., 205 U.S. 105, 121 (1907); Southwest Eng' r Co. v. United States, 341 F.2d 998 (8th Cir.), cert. denied, 382 U.S. 819 (1965); McCarthy v. Tally, 46 Cal. 2d 577, 585-86, 297 P.2d 981, 986-87 (1956) (en banc), noted in 4 U.C.L.A. L. Rev. 126 (1956).
12. Restatement of Contracts § 339(1)(b) (1932); see Interstate Indus. Uniform Rental Serv,
LIQUIDATED DAMAGES

criterion is one that has caused confusion in the case law. At the very least
one must question how parties can be expected to reasonably pre-estimate the
probable loss when the damages are very difficult to estimate accurately in the
first place. Furthermore, it is difficult to understand exactly what purpose
this criterion serves. It seems unnecessary to require the parties to prove
damages to a court or jury when the amount stipulated in the contract
adequately reflects the damages. Perhaps for these reasons, its importance has
recently been questioned. Despite the fact that this requirement is usually
recited as a prerequisite for finding a valid liquidated damages provision, "it
is a comparatively rare occasion where [it] is the determinant." One case
which clearly reflects this decline in significance interpreted this requirement
that the damages be uncertain as that uncertainty which "exists in a legal
sense in all other cases than agreement to pay a fixed amount, i.e., unless
damage is liquidated as a matter of law." Nevertheless it should be realized
that a liquidated damages clause is "most likely to be upheld in cases where
actual damages are most difficult to prove, as in the case of breach of a
covenant not to compete ...."

A third criterion which some courts add as a factor in determining whether
a specific provision is a liquidated damages clause or a penalty is the intention
of the parties. It is often said that for a provision to be upheld as a
liquidated damages clause, the parties must have intended that the provision

1. Inc. v. Couri Pontiac, Inc., 355 A.2d 913, 921 (Me. 1976); Growney v. C M H Real Estate Co.,
1976); Calamari & Perillo, supra note 3, § 232, at 367; McCormick, supra note 3, § 148, at 603.
(Me. 1976); Dobbs, supra note 6, § 12.5, at 822.
3. Professor McCormick argues that there is no sound objection to parties freeing "the judge
or jury of the task of fixing damages, even though that task would be an easy one and its result
could readily be forecast ...." McCormick, supra note 3, § 148, at 605. But see Macneil, Power
4. Calamari & Perillo, supra note 3, § 232, at 367; McCormick, supra note 3, § 148;
Crowley, supra note 9, at 61.
5. A recent New York case highlights the confusion regarding how strictly this criterion should be
applied. In a 4-3 decision, the appellate division upheld a liquidated damages clause stipulating
the damages for the defendant's breach of a contract under which 25 milk delivery trucks were
leased from the plaintiff. The majority argued that "[w]hen plaintiff agreed to specifically design
and provide trucks for this particular business, the parties, at the time of the inception of the
agreement, realized that it would be difficult to compute exactly what damages would result from
a future breach of that agreement." Truck Rent-A-Center, Inc. v. Puritan Farms 2nd, Inc., 51
App. Div. 2d 786, 787, 380 N.Y.S.2d 37, 40 (2d Dep't 1976) (mem.). However, the dissent found
that the evidence clearly showed that the "damages, in the event of a breach, could be ascertained
with almost mathematical precision." Id. at 788, 380 N.Y.S.2d at 41 (Shapiro, J., dissenting).
6. Crowley, supra note 9, at 61.
7. Callanan Road Improvement Co. v. Colonial S. & S. Co., 190 Misc. 418, 72 N.Y.S.2d
194 (Sup. Ct. 1947), cited approvingly in Crowley, supra note 9, at 61.
8. 190 Misc. at 422, 72 N.Y.S.2d at 198.
10. Id.; Corbin, supra note 6, § 1058, at 339; McCormick, supra note 3, § 149, at 606.
liquidate damages rather than act as a penalty. However, this factor is found to be inconclusive when the cases are analyzed. First, clauses which the parties have labelled as penalties have been upheld by the courts as liquidated damages. Conversely, the courts have felt free to refuse enforcement of provisions which the parties have labelled as a liquidated damages clause. Furthermore, courts have begun to realize that the parties making a contract focus their attention primarily on promised performances and means of securing those performances. Rarely do the parties "stop to...draw fine distinctions as to their exact intention" when they agree to a clause stipulating a sum of money to be paid in the event of a breach. Thus this criterion must be viewed as one of limited significance.

These three criteria constitute the common law requirements generally considered by courts in deciding whether a particular provision is enforceable as a liquidated damages provision or void as a penalty. As noted earlier, the law in this area is full of confusion and offers little certainty to lawyers requested to assist clients in drafting and interpreting provisions of this kind. It would therefore appear that this area of law might benefit substantially if it were reduced to a single uniform statute—such as the Uniform Commercial Code. In short, liquidated damages represent an area of the law where the Code, with its primary purpose on uniformity, could have a positive impact.

20. See, e.g., United States v. Bethlehem Steel Co., 205 U.S. 105, 120 (1907) (contract for construction of gun carriages referred to "penalties" for delay in completion); Blewett v. Front St Cable Ry., 51 F. 625, 627-28 (9th Cir. 1892) (bond fixing $18,000 as "penalty" in case of breach); Parker v. Whistle, 227 Ark. 731, 733-34, 301 S.W.2d 445, 447 (1957) (contract for sale of land provided that earnest money would be "forfeited" in the event of a breach); Tode v. Gross, 127 N.Y. 480, 487, 28 N.E. 469, 471 (1891) (contract for the sale of business included a "penalty" in the event the seller disclosed trade secrets).

21. See, e.g., Paradis v. Second Ave. Used Car Co., 61 So. 2d 919 (Fla. 1952) ("liquidated damages clause" in a contract for sale of real estate held to be a penalty because of no actual damages); Factory Realty Corp. v. Corbin-Holmes Shoe Co., 312 Mass. 325, 331, 44 N.E.2d 671, 674 (1942) ("liquidated damages clause" in a contract for the sale of a factory held to be a penalty because stipulated sum was not proportionate to damages in the event of a breach); Caeser v. Rubinson, 174 N.Y. 492, 497, 67 N.E. 58, 60 (1903) ("liquidated damages clause" in a lease held to be a penalty because damages were not difficult to ascertain).

22. Corbin, supra note 6, § 1058, at 339.

23. "On the question of whether the provision is a penalty or liquidated damages, we are not construing the contract with reference to intention of the parties. Intent is of no practical importance. The question is not what the parties intended, but "whether the sum is in fact in the nature of a penalty."" 5 S. Williston, A Treatise on the Law of Contracts § 777, at 682 (3rd ed. 1961), quoting from Central Trust Co. v. Wolf, 255 Mich. 8, 14, 237 N.W. 29, 31 (1931)

It is significant that the Restatement of Contracts § 339 does not include the parties' intention as a relevant factor in differentiating between a liquidated damages clause and a penalty.

24. See notes 1-2 supra and accompanying text.

II. LIQUIDATED DAMAGES UNDER UCC SECTION 2-718(1)

Section 2-718(1) of the Uniform Commercial Code\textsuperscript{26} is the principal section covering liquidated damages. It provides:

Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.\textsuperscript{27}

It should be readily apparent that the parties' intentions are not included as a criterion. This is in line with the more recent and probably better view that the parties' intentions are irrelevant to a determination of whether the stipulated sum is reasonable.\textsuperscript{28}

A. Anticipated or Actual Harm

The first criterion appears to follow the common law requirement that the stipulated sum be a reasonable pre-estimate of probable loss, but adds an alternative test—actual harm. The New York State Law Revision Commission points out that there is a problem of construction which the official comment to the Code fails to resolve.\textsuperscript{29} The two possible interpretations are: first, that if either actual or anticipated harm corresponds to the stipulated sum, the clause will be valid; second, that the clause will not be valid if the stipulated sum is disproportionate to either actual or anticipated harm. The Law Revision Commission concludes that the first interpretation is probably correct "so that if actual harm is in line with the stipulated sum, it will not be necessary to speculate concerning the parties' anticipations."\textsuperscript{30} This seems to be generally accepted by the commentators as the intended interpretation of the drafters.\textsuperscript{31}

This would appear a departure from pre-Code law. The New York Court of Appeals recognized this when it held that "decisions which have restricted their analysis of the validity of liquidated damages clauses solely to..." 

\textsuperscript{26} References are to the 1962 version of the Uniform Commercial Code [hereinafter cited as UCC].

\textsuperscript{27} UCC § 2-718(1). This section establishes three criteria for determining whether a particular clause is enforceable as a liquidated damages clause or void as a penalty. The stipulated sum is to be judged in light of (1) the anticipated or actual harm caused by the breach, (2) the difficulties of proof of loss and (3) the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy at law.

\textsuperscript{28} See notes 19-22 supra and accompanying text.

\textsuperscript{29} 1 New York State Law Revision Commission, Study of the Uniform Commercial Code 581 (1955) [hereinafter cited as Commission].

\textsuperscript{30} Id.

the anticipated harm at the time of contracting have, to this extent, been abrogated by the Uniform Commercial Code . . . ."^{32}

However, this idea that a liquidated damages clause may be valid if the stipulated sum is reasonably proportionate to actual harm is not totally new to the law. Professor Corbin actually endorsed the idea when he argued that there "is no good reason why the court should not enforce the provision in the contract"^{33} if the stipulated sum is proportionate to the actual injury caused by the breach but disproportionate to the probable injury at the time of the formation of the contract.^{34}

Prior to the Code, most courts concluded that the extent of actual harm is a factor in determining what losses might reasonably have been anticipated at the time the contract was formed.\textsuperscript{35} However, a minority of courts have excluded evidence of actual harm in deciding the validity of a liquidated damages provision\textsuperscript{36} and focused solely on what damages could reasonably have been anticipated. Thus, where a buyer was trying to enforce a liquidated damages provision against a defaulting seller, it was held inadmissible for the seller to introduce evidence that the goods were not worth what the buyer agreed to pay for them.\textsuperscript{37} This minority view reached its peak in \textit{Frick Co. v. Rubel Corp.},\textsuperscript{38} where the Second Circuit excluded evidence of actual damage in a suit for enforcement of a liquidated damages clause. The majority found that "evidence as to the actual loss was not material to the issue of the losses in contemplation . . . ."\textsuperscript{39} However, this decision has met with criticism\textsuperscript{40} and has failed to attract support from subsequent decisions. Judge Learned Hand, despite the fact he wrote the opinion, disagreed with his brethren on the ground that actual damages were of evidentiary value in showing the losses which were in contemplation when the contract was signed.\textsuperscript{41} This position is clearly in line with the majority view on this issue. Furthermore, there can be little doubt that the Code, with its alternative test of actual harm, follows the majority view. The language of the Code makes it clear that evidence of actual damages should always be admissible.

\begin{itemize}
  \item \textsuperscript{33} Corbin, supra note 6, \S 1063, at 367.
  \item \textsuperscript{34} It should be noted that Corbin’s position is not supported by any court decisions.
  \item \textsuperscript{35} Woodner v. Sankin, 188 F. Supp. 259 (D.D.C. 1960), aff’d, 289 F.2d 873 (D.C Cir 1961) (per curiam); In re Gelino’s, Inc., 43 F.2d 832, 833-34 (E.D. Ill. 1930); In re Liberty Doll Co., 242 F. 695, 699 (S.D.N.Y. 1917); see Corbin, supra note 6, \S 1063, at 368.
  \item \textsuperscript{36} Frick Co. v. Rubel Corp., 62 F.2d 765 (2d Cir. 1933); Pierce v. Jung, 10 Wis. 25 (1859).
  \item \textsuperscript{37} Pierce v. Jung, 10 Wis. 25 (1859). The defendant had agreed to sell a stock of goods worth over $4,000 to the plaintiff under a contract stipulating damages at $1,000 in the event of a breach. The court found that the damages were not disproportionate to the probable damage and were incapable of being accurately ascertained. Id. at 29.
  \item \textsuperscript{38} 62 F.2d 765 (2d Cir. 1933) (buyer defaulted by delay in taking delivery of icemaking machinery).
  \item \textsuperscript{39} Id. at 768.
  \item \textsuperscript{40} Calamari & Perillo, supra note 3, \S 232, at 368 n.53.
  \item \textsuperscript{41} 62 F.2d at 768.
\end{itemize}
Outside of abrogating those cases following the minority point of view—on the materiality of evidence of actual harm—there does remain substantial doubt about the significance of the addition of actual harm as an alternative test for measuring the validity of a liquidated damages provision. It is difficult to conceive of a common fact pattern in which liquidated damages would be unreasonable in light of anticipated damages yet reasonable in light of actual damages. Furthermore, under the common law, a reasonable proportion between the liquidated and actual damages was usually a basis for finding a reasonable estimate of damages. This may lead to a conclusion that the change in the law made by the Code is not significant. However, the recent case of *Equitable Lumber Corp. v. IPA Land Development Corp.* illustrates the impact the statute sought to achieve. The defendant-purchaser took delivery of lumber from the plaintiff under a contract which provided that the seller could recover attorney's fees in the event an attorney's services were necessary to collect payments due under the contract. The attorney's fees were stipulated at 30 percent of the amount recovered by the seller.

Special term found that the defendant was liable to the plaintiff in the amount of $3,936.42 for the sale of the lumber, but found that the stipulated attorney's fees were excessive. After conducting a hearing on the extent of the services performed by the plaintiff's attorney, the court concluded that the reasonable value of the services was $450, approximately 11 percent of the amount recovered. The appellate division modified the award by raising the plaintiff's recovery of attorney's fees to $750 yet affirmed special term's finding that the 30 percent figure was disproportionate to the amount of time and effort which was required to properly represent plaintiff in this matter.

The court of appeals reversed and held that the lower courts had not properly applied section 2-718(1). The court stated that "an attorney would be expected to bill his client on a contingent fee basis" and therefore the court should determine whether the 30 percent stipulation was a reasonable pre-estimate of anticipated harm or in the alternative whether the 30 percent stipulation was consistent with the actual arrangement the plaintiff had with its attorneys. Thus, the court applied the alternative tests found in the section. If the stipulated attorney's fee were reasonably related to the normal contingent fee charged by attorneys in such circumstances, then the provision would contain a reasonable pre-estimate of anticipated harm and consequently would be a valid liquidated damages clause. Alternatively, the court reasoned, if the plaintiff actually entered into a contingent fee arrange-
ment with its attorney for 30 percent, then the liquidated damages provision would be reasonably proportionate to actual harm and therefore valid.\textsuperscript{49}

However, the court of appeals also added a second test to its interpretation of the Code. It held that "even if the 'actual harm' test is satisfied, it is then necessary, pursuant to the second sentence of subdivision (1) . . . , to determine whether the liquidated damages provision is so unreasonably large as to be void as a penalty."\textsuperscript{50} The court reasoned that if the plaintiff, realizing that the defendant would suffer the consequences, entered into an exorbitant fee arrangement with its attorney, then the provision would be void as a penalty. Though citing no support, the court has proposed a second test which arguably the statute itself does not require.\textsuperscript{51}

The court was concerned that the plaintiff "should not be permitted to manipulate the actual damage incurred by burdening the defendant with an exorbitant fee arrangement."\textsuperscript{52} While there is no question that this is a valid concern, the court's analysis of the point appears misplaced. The issue of the plaintiff manipulating the actual harm more appropriately could be analyzed under the definition of "actual harm," rather than imposing a second test to determine whether the stipulated sum is unreasonably large—a determination supposedly made by the first test. It would have been more expedient for the court to focus on exactly what the term "actual harm" meant under the facts of the case.

If the court had held that the term "actual harm" referred to damages which the injured party could recover in the absence of liquidated damages, then the actual harm would be the reasonable value of the attorney's services. Such an interpretation would eliminate any issue of whether the plaintiff had intentionally agreed to an exorbitant fee arrangement.

Alternatively, the court could have interpreted "actual harm" as the actual fee arrangement between the plaintiff and its attorney, but added that "actual harm" incorporates the rule of avoidable consequences.\textsuperscript{53} This would have imposed on the plaintiff a duty to mitigate damages and the "actual harm" would not reflect any higher percentage contingent fee arrangement than a reasonable man under similar circumstances would have agreed to. For example, if the court determined that the plaintiff could have obtained the services of a competent attorney without undue difficulty on a 25 percent contingent fee basis, then the 25 percent figure would represent the "actual harm." The court would then have to decide whether the 30 percent stipulation was reasonable in light of the 25 percent "actual harm." Either of these interpretations would have prevented the plaintiff from manipulating the "actual harm" and avoided the second test which the \textit{Equitable Lumber} court found necessary.

\textsuperscript{49} Id.
\textsuperscript{50} Id.
\textsuperscript{51} See notes 110-12 infra and accompanying text for a discussion of the second sentence of UCC § 2-718(1).
\textsuperscript{52} 38 N.Y.2d at 524, 344 N.E.2d at 397, 381 N.Y.S.2d at 465.
\textsuperscript{53} Dobbs, supra note 6, § 12.6. at 826.
However, it should be noted that a precise determination of what the Code drafters meant by the term "actual harm" is unclear. One commentator poses the question, but makes no attempt to resolve the issue, when he states that "[t]he difficulty exists because of the use of the adjective 'actual' " and suggests the term may refer to either harm which has in fact occurred or merely to damages which are legally recoverable. The issue simply is whether rules of damage assessment regarding certainty, foreseeability, and causation apply to the term "actual harm."

The rule of certainty which requires that damages not be unreasonably speculative is not strictly applied to anticipated harm and there is no reason to presume that it would be a serious factor in judging actual harm.

The rule of foreseeability, which has been adopted by the Code, limits recovery to those damages which are reasonably foreseeable at the time of making the contract. The New York Law Revision Commission has stated that damages which are not foreseeable "must be excluded from the 'harm caused by the breach' for the purpose of determining the reasonableness of the agreement on liquidated damages." This interpretation, although perhaps correct, has the result of narrowing the distinction between anticipated and actual harm. If actual harm is limited to those damages which are reasonably foreseeable at the time of the making of the contract, then there may not be a significant difference between actual harm and harm anticipated at the time the parties agreed to the liquidated damages clause. Thus, the Law Revision Commission's interpretation of actual harm may pose a major limitation to the Code's alternative test for measuring the validity of liquidated damages clauses. This fact argues strongly against such an interpretation.

The third rule regarding contract damages states that in order to be recoverable the damages must be "caused" by the breach. The language of the Code itself makes it clear that in order to be valid a liquidated damages clause must be reasonable "in light of the anticipated or actual harm caused by the breach." The use of the word "caused" is certainly evidence that the rule of contract damages regarding causation applies to the term "actual harm" as used in the Code.

In light of the discussion of what is meant by the term "actual harm," it should be noted that Equitable Lumber may be interpreted as differentiating

---

54. Crowley, supra note 9, at 74.
55. Dobbs, supra note 6, § 3.3, at 148.
56. See, e.g., United States v. Bethlehem Steel Co., 205 U.S. 105 (1907) where the Supreme Court upheld a liquidated damages clause as a reasonable estimate of probable harm to the war effort likely to result from the defendant's delay in delivery of war materials.
57. The rule of certainty has been liberalized both by the Code (UCC § 2-715, Comment 4) and recent cases (see, e.g., Isaacs v. Incentive Sys., Inc., 52 App. Div. 2d 550, 382 N.Y.S.2d 69 (1st Dep't 1976) (per curiam)).
58. UCC § 2-715(2)(a).
59. The rule is based on the principle in the famous case of Hadley v. Baxendale, 156 Eng. Rep. 145 (Ex. 1854) and subsequent liberalization of that principle. Dobbs, supra note 6, § 12.3
60. Commission, supra note 29, at 581 n.468.
between "actual harm" and damages that are recoverable under common law rules of contract damages. The New York Court of Appeals views the actual harm in *Equitable Lumber* as the actual fee arrangement between the plaintiff and its attorney. As the lower court's decision made clear, under common law contract rules this would not be the amount of recovery, but instead the recovery would be limited to the reasonable value of the attorney's services. Thus, it may be concluded that the court of appeals interpreted "actual harm" as harm in fact rather than referring to legally recoverable damages. However, this conclusion should not be considered as strong precedent because the court did not directly address the issue.

One area where the Code's "actual harm" test may have a significant impact would be in undermining the effect of the "multiple breach" rule. The common law view is that a single stipulated sum could not validly cover the breach of a number of covenants of varying importance. Thus unless the stipulated sum is reasonable in light of every possible breach covered by the liquidated damages clause, the clause will be void as a penalty. However, the Code may have provided a way to circumvent this rule. Instead of being confined to looking at whether the stipulated sum was a reasonable pre-estimate of damages, the party seeking to enforce the liquidated damages clause has the opportunity to show the stipulated sum was reasonably proportionate to the actual harm. This second test removes the issue of whether other possible breaches are covered by the liquidated damages provision by focusing solely on the "actual harm caused by the breach." Professor Dobbs agrees with this result but reaches the conclusion by different analysis. He agrees that the Code "does not measure reasonableness by other breaches that would have been possible but did not in fact occur ...." However, his conclusion is based on the use of the word "the" in the phrase "reasonable in the light of the anticipated or actual harm caused by the breach." By focusing exclusively on the breach which is being sued upon, the Code has abrogated the common law "multiple breach" rule. Thus, under either the alternative "actual harm" test or Dobbs' theory, a strong argument can be made that the drafters of the Code intended to preserve an otherwise valid liquidated damages clause despite the fact that it stipulates a single sum for several possible breaches of varying importance.

**B. Difficulties of Proof of Loss**

The second criterion under the Code for determining the validity of a liquidated damages clause is that the provision be "reasonable in light of ... the difficulties of proof of loss." This test is generally viewed as the codifica-
The first problem presented by this criterion is the time at which the difficulties should be judged. Should the uncertainty of the loss be viewed at the time of formation of the contract or at the time the contract was breached? The actual Code language, by use of the word “proving,” seems to focus on the time of trial while the common law requirement focuses on the difficulty in estimating damages at the time the contract was made. If the Code drafters meant to refer to the time of trial (or even breach) they would be imposing a stricter standard for reviewing liquidated damages clauses than under pre-Code law. Even though it may be difficult to estimate damages at the time a contract was formed, it is very possible it will no longer be difficult once the breach occurs. There is no evidence that the Code intended to impose a stricter standard than the common law. In fact, Professor Crowley argues that “while the Code does say that the reasonableness of the amount is to be considered ‘in the light of . . . the difficulties of proof of loss,’ it would seem that the intent of the draftsmen was simply to restate the common law norm which requires for a valid liquidated damages clause that the damage caused by the breach be one difficult of estimation.”

If the courts were to follow the language of the statute literally and apply the stricter standard, they may well invalidate most liquidated damages provisions covered by the Code. Generally, damages are not difficult to prove in a suit for the breach of a contract for the sale of goods. Because the difference between the contract price and the market value at the time of breach is the proper measure of damages for breach of contract and since the market value of most goods at the time of breach is fairly easy to ascertain once the breach has occurred, one might conclude that a valid liquidated damages provision would be rare under the Code.

Indeed, this is the result under California law which has a statute requiring uncertainty at the time of the breach for a valid liquidated damages clause. Under this statute “[o]nly when goods are purchased for a special purpose or have a special value is it possible to liquidate damages validly for breach of a goods contract.” Given this result, it seems doubtful that the drafters of the Code intended the difficulties in proving loss to be viewed at the time of breach or trial. It is more likely that they intended to conform to the common law view that the uncertainty be examined at the time the contract was agreed to. Professor Sweet clearly endorses such an interpretation when he concludes that the Code “appears to validate clauses that appear to be reasonable in terms of anticipated damages even where the court may believe that the damages are not difficult to ascertain at the time of trial.”

66. Commission, supra note 29, at 582; Crowley, supra note 9, at 74. For a discussion of the common law requirement see notes 11-18 supra and accompanying text.
67. Corbin, supra note 6, § 1060, at 350; Crowley, supra note 9, at 60.
68. Crowley, supra note 9, at 75.
70. Sweet, supra note 5, at 106.
71. Id. at 109 (emphasis added).
However, there is even a more basic problem under this criterion than just the proper time for applying it. Prior to the enactment of the Code, there was uncertainty as to the significance of the common law test. The cases and commentators were in conflict as to what kind or degree of difficulty was required. Professor Dobbs points out that the "difficulty might stem from the nature of the damage claimed, or the difficulty of securing witnesses or the difficulty of knowing what damages will be said by courts to be 'within the contemplation of the parties.'" Dobbs concludes that any form of difficulty should probably be sufficient to uphold a liquidated damages clause. Whether this liberal view will be accepted as the proper interpretation of the Code has been the subject of speculation. Professor Crowley seems to doubt it. Instead he concludes that "the incorporation of this criterion into the [Code] will . . . undoubtedly give to this criterion a force and effect which it has not enjoyed in the common law." Professors Calamari and Perillo are less certain but express hope that this test will remain a makeweight, as they viewed it under the common law. But Dean Hawkland expresses no concern about the inclusion of this criterion into the Code. He argues that "[w]ithout this justification, the [liquidated damages] clause fails of its central purpose, and, in this event, there is no reason to utilize it instead of the normal remedies for damages provided by law." However, Hawkland makes it clear that he considers "the difficulty and expense of acquiring or presenting evidence to establish actual damages" or "the hazard of being exposed to the vagaries of a jury passing on the amount of damages" sufficient to justify the use of a liquidated damages clause. It is hard to conceive of a fact pattern involving a breach of a contract for the sale of goods which would not meet the minimal requirements of Hawkland's interpretation. If this is the case, then his view makes this criterion a practical nullity which is certainly an arguable conclusion.

In *Equitable Lumber Corp. v. IPA Land Development Corp.*, the New York Court of Appeals referred directly to the common law requirement of uncertainty in their analysis of a liquidated damages clause. The court found

---

72. See notes 14-18 supra and accompanying text.
73. Calamari & Perillo, supra note 3, § 232, at 367; Crowley, supra note 9, at 60-61; Macneil, Power of Contract and Agreed Remedies, 47 Cornell L.Q. 495, 501-03 (1962).
74. Dobbs, supra note 6, § 12.5, at 822.
75. Id.
76. Crowley, supra note 9, at 74-75.
77. Calamari & Perillo, supra note 3, § 236, at 370.
78. Hawkland, supra note 31, at 171.
79. Id.
80. Id.
81. Both of these justifications were originally cited by the N.Y. Law Revision Commission as "the central justification for the enforcement of liquidated damage clauses." Commission, supra note 29, at 582.
82. Professor Crowley argues against such an interpretation for just this reason. Crowley, supra note 9, at 75.
that "[a]t the time of contracting the attorney's fees were arguably incapable of estimation."\textsuperscript{84} The court reasoned that "[t]he amount required for attorney's fees would vary with the nature of the defaulting party's breach\textsuperscript{85} depending on whether litigation or appellate review were required to obtain collection of unpaid amounts due under the contract.

First it should be noted that the court without hesitation applied the standard common law "difficulty of estimation" test. The court made no reference to the Code's "difficulties of proof of loss" in its analysis of the uncertainty of the damages to be caused by the defendant's breach. It is arguable, therefore, that the court chose to interpret the Code as simply restating the common law. Also of significance is the fact that the court looked "[a]t the time of contracting\textsuperscript{86} rather than at the time of breach, again following the common law rule.

However, the court's application of this test to the facts is puzzling. It reasoned that the amount of the attorney's fees would vary with the breach. This statement would have been appropriate if the parties had stipulated a single amount of money as damages, but instead the parties stipulated a percentage of the amount recovered by the attorney. Surely the court did not believe that the attorney's contingent fee would vary depending on whether litigation or appellate review were necessary. In fact, the contingent fee necessary to obtain the services of a reasonable attorney might have been very easy to estimate at the time the contract was formed. Nevertheless the court concluded that the provision in question satisfied the "difficulty of estimation" test and consequently the Code's second criterion.

A subsequent case, \textit{Lee Oldsmobile, Inc. v. Kaiden},\textsuperscript{87} focused on this issue and left in doubt the loose manner in which the second criterion was applied in \textit{Equitable Lumber}. In that case a purchaser breached a contract for the sale of a Rolls-Royce automobile.\textsuperscript{88} The contract included a provision which gave the seller "the right, upon failure or refusal of the purchaser to accept delivery of the motor vehicle, to retain as liquidated damages any cash deposit made by the purchaser."\textsuperscript{89} Evidence was submitted that the seller's actual damages were $5,080, the bulk of which was the $3,005 difference between the contract price and the resale price two months after the breach. The seller argued that since the buyer's deposit was $5,000, the provision stipulating damages should be upheld as a valid liquidated damages clause pursuant to the "actual harm" test of section 2-718.\textsuperscript{90}

However, the court ruled against the seller and stated:

We reject the application of the liquidated damage clause in the present case, as the trial judge did below, because it is clear that the actual damages are capable of

\textsuperscript{84} Id. at 523, 344 N.E.2d at 396-97, 381 N.Y.S.2d at 464.
\textsuperscript{85} Id. at 523, 344 N.E.2d at 397, 381 N.Y.S.2d at 464.
\textsuperscript{86} Id. at 523, 344 N.E.2d at 396-97, 381 N.Y.S.2d at 464.
\textsuperscript{88} Id. at —, 363 A.2d at 271.
\textsuperscript{89} Id. at —, 363 A.2d at 273.
\textsuperscript{90} Id.
accurate estimation. We do not say this from hindsight made possible because the actual figures claimed were in evidence. We say it because at the time the contract was made, it was clear that the nature of any damages which would result from a possible future breach was such that they would be easily ascertainable.\footnote{91}

The court was clearly applying the common law test of whether the damages were incapable of accurate estimation and failed to use the Code's language—"difficulties of proof of loss." However, the court applied the test in an exceptionally strict form. The court itself found that this seller had an allotted quota of 10 or 11 of these rare luxury automobiles to sell during the year the contract was made.\footnote{92} Furthermore the evidence was undisputed that this Maryland seller waited two months after the New York buyer defaulted to resell the same automobile to a Georgia buyer for $3,000 less than the original price. It seems difficult to imagine how the damages from the breach of a contract for the sale of such an expensive, rare automobile in a limited market could be capable of accurate estimation. If the facts of the case involved a standard model automobile produced in the United States, then the court's analysis would have been more appropriate.

The court added to the problems involved in the application of this criterion when in dictum it attempted to reinforce its conclusion:

That the total of the itemized claims, each easily and precisely ascertainable, was almost identical with the amount claimed as liquidated damages, is either a mere coincidence or a demonstration that there would be no difficulty in ascertaining damages in the event of a breach, which robs the liquidated damage clause of a necessary premise.\footnote{93}

If the court meant to imply that the fact that the stipulated sum and the alleged actual damages were almost identical was some evidence that the damages were not difficult to estimate, then it has seriously undermined section 2-718. Such reasoning leads to the conclusion that a stipulated sum which is sufficiently close to actual damages to satisfy the first criterion's "actual harm" test may have the effect of violating the second criterion. Such a result is clearly contrary to the language of the section.

Hopefully courts in the future will choose to apply the Code's second test in the broad manner found in \textit{Equitable Lumber}, rather than the more restrictive application found in \textit{Lee Oldsmobile}. There appears to be no compelling reason to invalidate a liquidated damages clause simply because the damages are not difficult to estimate accurately. This requirement stems from the historical development that liquidated damages provisions were used to avoid being denied recovery under the rule of certainty.\footnote{94} Today the rule of certainty has been liberalized\footnote{95} and it is recognized that these provisions serve other valid purposes: they minimize trial time,\footnote{96} provide a degree of certainty

\footnotesize
\begin{itemize}
\item \footnote{91}{Id. at —, 363 A.2d at 274.}
\item \footnote{92}{Id. at —, 363 A.2d at 271.}
\item \footnote{93}{Id. at —, 363 A.2d at 274 n.5.}
\item \footnote{94}{Crowley, supra note 9, at 61.}
\item \footnote{95}{See note 57 supra.}
\item \footnote{96}{Corbin, supra note 6, § 1060, at 348; Dobbs, supra note 6, § 12.5, at 823.}
\end{itemize}
for the parties in the event of a breach,97 and limit the parties’ risk exposure.98 These important benefits derived from liquidated damages clauses should not be ignored by imposing an out-dated test. For these reasons it is hoped that this criterion will continue to diminish in significance and will not gain new recognition through the Code’s “difficulties of proof of loss” test.

C. Inconvenience or Nonfeasibility of Otherwise Obtaining an Adequate Remedy

The third Code criterion is that the stipulated sum in the liquidated damages provision be reasonable in light of “the inconvenience or non-feasibility of otherwise obtaining an adequate remedy.” The meaning of this rather vague third test is not clear, especially since it has no direct counterpart in pre-Code law.99 It is difficult to understand what purpose it serves that is not also served by the second test. Professor Crowley states that “this criterion appears to be duplicative of the second criterion or at most explicative thereof.”100

The New York Law Revision Commission suggests one possible interpretation.101 The Commission is of the opinion that certain Code sections, such as the seller’s right to resale102 and the buyer’s right to “cover,”103 may provide adequate remedies. This would have the effect of invalidating a liquidated damages provision where such remedies were available. This interpretation is supported by Hawkland who argues that “[i]f subsequent events make it clear that an adequate remedy is conveniently and feasibly available, the liquidated damages provision fails of its essential purpose and must give way to the general remedies provided by law.”104 Hawkland supports this statement by referring to section 2-719(2) of the Code which provides that “[w]here circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act.”105 Hawkland concludes that the “only legitimate purpose for stipulating damages in advance is to prevent the ‘inconvenience or non-feasibility of otherwise obtaining an adequate remedy.’”106 This argument, despite its logical merit, has the practical effect of invalidating most liquidated damages provisions because the Code provides an adequate remedy for most cases covered by it.107

98. Dobbs, supra note 6, § 12.5, at 823; Sweet, supra note 5, at 86.
99. Calamari & Perillo, supra note 3, § 236; Commission, supra note 29, at 582; Crowley, supra note 9, at 75.
100. Crowley, supra note 9, at 75.
101. Commission, supra note 29, at 582.
102. UCC § 2-706.
103. UCC § 2-712.
104. Hawkland, supra note 31, at 172.
105. UCC § 2-719(2).
107. Buyer's remedies are found in § 2-712 (buyer's right to "cover"); § 2-713 (damages for non-delivery or repudiation); § 2-714 (damages where non-conforming goods are accepted);
Furthermore, there are practical reasons for stipulating damages in advance of a breach beyond the question of whether an adequate remedy would otherwise be inconvenient or nonfeasible.\textsuperscript{108} For example, the fact that subsequent events make it clear that an adequate remedy is available does not negate the benefit of the time saved at trial by not having to prove damages. In addition, a strong argument can be made against such an interpretation by looking at the first criterion under the Code—a liquidated damages provision will be upheld if the stipulated sum is reasonably proportionate to actual harm. Assuming that actual harm is measured as damages which can be legally recovered,\textsuperscript{109} then an inconsistency exists between the first and third requirements. The third criterion dictates that if actual damages can be measured then the liquidated damages provision must be denied enforcement because of the existence of an adequate remedy—actual damages. However, the measurement of actual damages is used to uphold liquidated damages clauses under the first criterion. This inconsistency is strong evidence that the drafters did not intend the third criterion to invalidate a liquidated damages provision every time actual damages were available as an adequate remedy.

Another difficulty in interpreting the Code's third test is that it focuses on circumstances as they exist at the time of breach, not formation, of the contract. Thus Hawkland apparently would deny enforcement of a provision stipulating damages where there did not appear to be an adequate remedy at the time of formation of the contract, yet, at the time the contract was breached, subsequent events had made an adequate remedy available. This seems unreasonably harsh and despite no indication in the Code language or the official comment that such a result was not intended, it is hoped that the vague and seemingly contradictory third criterion will be applied only to the time of formation of the contract, if at all.

D. Unreasonably Large Liquidated Damages

The second and last sentence of section 2-718(1) of the Code provides that "[a] term fixing unreasonably large liquidated damages is void as a penalty." This restates the general principle underlying the law regarding liquidated damages.

One initial problem with this sentence is how it relates to the first sentence in the section. There is some confusion about whether the second sentence is another test altogether or whether it merely clarifies the first sentence. The language of the statute itself seems to favor the latter interpretation. Under this view the first sentence gives three criteria for determining the reasonableness referred to in the second sentence. Thus, if a provision stipulating

\textsuperscript{108} See notes 96-98 supra and accompanying text.
\textsuperscript{109} This assumption is discussed in notes 54-62 supra and accompanying text.
LIQUIDATED DAMAGES

 damages meets the three criteria, then, a fortiori, the provision cannot be found void as a penalty under the second sentence. This view is supported by the official comment to section 2-718 which states that subsection (1) "sets forth explicitly the elements to be considered in determining the reasonableness of a liquidated damage clause."\footnote{110}

However, the New York Court of Appeals in Equitable Lumber adopted the first view and interpreted the second sentence as providing a separate test from the first sentence. The court stated that "[h]aving satisfied the test set forth in the first part of subdivision (1) of section 2-718, a liquidated damages provision may nonetheless be invalidated under the last sentence of the section if it is so unreasonably large that it serves as a penalty rather than a good faith attempt to pre-estimate damages . . . ."\footnote{111} This implies that a liquidated damages clause could be reasonably proportionate to anticipated or actual harm and yet not be enforceable because it is not a good faith attempt to pre-estimate damages. The court, in remanding to special term, used this interpretation to instruct the lower court that even if the stipulated agreement were reasonable in light of actual harm, "the court on remand should determine whether the amount stipulated was unreasonably large or grossly disproportionate to the damages which the plaintiff was likely to suffer from breach [of the contract] . . . ."\footnote{112}

This may have the effect of negating the Code's alternative of "actual harm" under the first test. If the court is required to look at whether the amount stipulated was grossly disproportionate to the damages likely to be suffered by the injured party, then the court may not restrict its analysis of the liquidated damages clause solely to the actual harm at the time of trial. This result is contrary to the language of the first criterion regarding either anticipated or actual harm. Whether such a result was really intended by the Equitable Lumber court is doubtful. It is more appropriate to view the second sentence of section 2-718(1) as clarifying the first sentence.

The second sentence of the statute presents a more obvious problem in its reference to "unreasonably large liquidated damages"—what about unreasonably small liquidated damages? While the majority of cases in this area raise the issue of whether the stipulated sum is unreasonably high, it is not unusual to find a decision determining the reasonableness of a small stipulated sum.\footnote{113} The official comment to this section notes that a liquidated damages clause stipulating "[a]n unreasonably small amount would be subject to similar

\footnote{110} UCC § 2-718, Comment 1. Hawkland also seems to favor this view when he writes about "[t]he second criterion of reasonableness" and "[t]he third test of reasonableness." Hawkland, supra note 31, at 171.

\footnote{111} 38 N.Y.2d at 521, 344 N.E.2d at 395, 381 N.Y.S.2d at 463. Both Dobbs and Sweet argue that the Code does not look at the subjective intentions of the parties. Dobbs, supra note 6, § 12.5, at 823 n.14; Sweet, supra note 5, at 109.

\footnote{112} 38 N.Y.2d at 524, 344 N.E.2d at 397, 381 N.Y.S.2d at 465

\footnote{113} See Fritz, "Underliquidated" Damages as Limitation of Liability, 33 Texas L. Rev 196 (1954). Many of these cases arise in a consumer field context where the seller has attempted to limit his potential liability by inserting into the sales agreement a provision with a small sum liquidating damages.
criticism [as that of an unreasonably large amount] and might be stricken under the section on unconscionable contracts or clauses.\textsuperscript{1114} This makes direct reference to section 2-302 of the Code which allows a court to refuse to enforce a contract found to be unconscionable.\textsuperscript{1115}

However, this reference to unconscionability and section 2-302 creates inconsistencies between the analysis of large liquidated damages clauses under section 2-718(1) and small liquidated damages clauses under section 2-302. First, section 2-302 gives the parties the right to a hearing on the issue of unconscionability. This is because the unconscionability is to be judged not merely from the terms of the contract but rather "in the context of its background and operation."\textsuperscript{1116} Obviously no such right exists under section 2-718(1). But perhaps this distinction will not be given much significance by the courts. When the Seventh Circuit Court of Appeals was confronted with the issue in Dow Corning Corp. v. Capitol Aviation, Inc.,\textsuperscript{1117} it upheld an allegedly small liquidated damages clause despite the lack of a hearing by the trial court. The court stated that "[i]t would have been better practice for the District Court to have held a hearing pursuant to Section 2-302 of the Code. . . . [b]ut the printed and the written evidence before us is sufficient for us to determine if the trial court erred in holding [the liquidated damages clause] to be unreasonable and unconscionable."\textsuperscript{1118} This is especially significant because the court of appeals was reversing the district court's determination that the clause in question was invalid. Thus, there is some authority that a hearing, although preferable, is not essential to the analysis of an allegedly small liquidated damages clause.

A second inconsistency concerns the appropriate time for considering the reasonableness or unconscionability of a liquidated damages clause.\textsuperscript{1119} Under section 2-718(1) the reasonableness of the stipulated amount is determined in light of either the "anticipated or actual harm caused by the breach." But

\begin{quote}
\textsuperscript{1114} UCC § 2-718, Comment 1.
\textsuperscript{1115} UCC § 2-302 provides: "(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the uncon- scionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result. (2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination."

It should be noted that unconscionability is sometimes a factor in common law cases regarding unreasonably large liquidated damages provisions. Nu Dimensions Figure Salons v. Becerra, 73 Misc. 2d 140, 340 N.Y.S.2d 268 (Civ. Ct. 1973). This case involved the sale of services rather than goods and therefore was not decided under the Code. However, the court makes reference to unconscionability under the Code in its opinion.

\textsuperscript{1116} 1 R. Anderson, Uniform Commercial Code § 2-302:21 (2d ed. 1970) [hereinafter cited as Anderson].
\textsuperscript{1117} 411 F.2d 622 (7th Cir. 1969).
\textsuperscript{1118} Id. at 627.
\textsuperscript{1119} Crowley, supra note 9, at 78.
under section 2-302, the unconscionability of the stipulated amount is to be judged at the time the contract was made. 120 Thus a stipulated sum that is unconscionably small at the time the contract was made may not be upheld if due to a change in circumstances it later turns out to be reasonably proportionate to the actual damages caused by the breach. This is contrary to section 2-718(1) and appears to have the effect of limiting the “actual harm” test under the first criterion only to provisions which are alleged to contain unreasonably large stipulated sums. Whether this was the intention of the Code’s drafters is questionable.

III. A LIQUIDATED DAMAGES CLAUSE AS THE EXCLUSIVE REMEDY

One recurrent issue in the area of liquidated damages is whether the clause, assuming it is valid and enforceable, is the exclusive remedy for breach of the particular contract. Despite the existence of a liquidated damages provision in a contract, the party injured by the breach of the contract often seeks additional or alternative remedies including actual damages, specific performance, or an injunction to restrain a continuing breach. The general rule is that liquidated damages clauses prohibit actions at law for money damages but do not preclude equitable relief. 121 However, as with most general rules, this is an oversimplification of the law especially in light of the Uniform Commercial Code.

A. Common Law Rule

The first half of the general rule is that the injured party may not recover actual damages, but instead is limited solely to the stipulated sum in the liquidated damages clause. Once a particular provision is held to be a valid and enforceable liquidated damages clause, “[t]he function of the court and jury in estimating injury has been superseded.” 122 This proposition is self-evident. If it were otherwise, a liquidated damages clause would lose its very purpose—to avoid the difficulties and uncertainties of proving damages.

Based on this principle, it is generally held that provisions which allow a party the option of recovering the stipulated sum or proving damages are unenforceable. 123 A recent Georgia appellate decision 124 presents an en-

121. Calamari & Perillo, supra note 3, § 234; Corbin, supra note 6, § 1061, 5A id. § 1213, Dobbs, supra note 6, § 12.5, at 825; McCormick, supra note 3, § 152.
122. Corbin, supra note 6, § 1061, at 353.
123. Jarro Bldg. Indus. Corp. v. Schwartz, 54 Misc. 2d 13, 281 N.Y.S.2d 420 (2d Dep’t 1967) (contract provided that one party could recover liquidated damages in the amount of 25 percent of the total contract price and, in addition, sue for actual damages); Dalston Constr. Corp v Wallace, 26 Misc. 2d 698, 214 N.Y.S.2d 191 (Dist. Ct. 1960) (a construction contract provided that the contractor could recover 20% of the contract price or sue for actual damages); Calamari & Perillo, supra note 3, § 233, at 369. Cf. Air Prods. & Chem., Inc. v. Fairbanks Morse, Inc., 58 Wis. 2d 193, 203-06, 206 N.W.2d 414, 420 (1973) (contract providing that buyer’s right to recover liquidated damages for delay in delivery was in addition to all other remedies available to the buyer held to be “inconsistent and ambiguous”).
lightened discussion of the principle. The contract being sued upon contained language which allowed the seller of land to retain a deposit made by the purchaser as liquidated damages and also to “pursue any and all remedies at law or equity including, but not limited to, an action for specific performance of this Contract.” The majority found this language sufficient to prevent the sum from being a valid liquidated damages provision. Adhering to the general rule, the court stated that “[i]f the sum certain is recoverable, in addition to damages, it matters not by what name it is called, it is still a penalty.”

The dissent argued that since “no sum of money is sought in addition to liquidated damages,” the language giving the party the right to pursue other remedies is irrelevant. This argument seems unpersuasive because the validity of the liquidated damages clause should not be determined by whether the injured party attempted to recover additional damages, but whether the parties intended that the stipulated sum represent the full liability of the breaching party.

One particular group of cases where this point has been frequently litigated involves contracts for the sale of security devices. In many contracts for the sale of such items as burglar alarms, the parties include a liquidated damages clause setting the seller's liability at a fixed sum in the event the device fails in its protection of the buyer's property. Despite substantial differences between the stipulated sum and the actual damages caused by the failure of such devices, the courts have upheld these provisions limiting the seller's liability as valid liquidated damages clauses. One issue before the courts in such cases is whether the admittedly valid liquidated damages clause prevents the injured party from recovering his actual damages in a cause of action based on negligence rather than breach of contract. In Better Foods Markets, Inc. v. American District Telegraph Co., the California Supreme Court stated:

The plaintiff seeks to avoid the effect of the liquidation clause on the ground that it has no application to a tort action. However, the plaintiff makes no claim that a duty was owed to it outside of that created by the contract, and no breach of duty was alleged other than a failure to render the contracted for service.

Thus the court concluded that the liquidated damages represented the seller's total liability even where the cause of action was based on negligence. This is consistent with the general rule preventing recovery of actual damages for breach of a contract containing a liquidated damages provision.

125. Id. at 775, 224 S.E.2d at 749.
126. Id. at 775, 224 S.E.2d at 750.
127. Id. at 777, 224 S.E.2d at 750.
129. 40 Cal. 2d 179, 253 P.2d 10 (1953) (en banc).
130. Id. at 187-88, 253 P.2d at 15.
However, actual damages may be recovered where they result from a particular breach which is not covered under the liquidated damages clause. In construction contracts, for example, actual damages have been recovered from contractors who abandoned the job but had agreed to a liquidated damages provision for harm caused by a delay in completion. In such cases the courts conclude that the parties only intended to liquidate the damages if the building is completed, but behind schedule. Thus an injured party has been allowed to recover actual damages by arguing that the liquidated damages provision applies only to a particular breach not at issue before the court.

While this principle allowing recovery of actual damages is well settled, the issue becomes open to debate when it is applied to different elements of damages arising out of a single breach. In *J. E. Hathaway & Co. v. United States*, the Supreme Court enforced a contract provision which allowed the government to recover 100 dollars per day for a contractor's delay in completion and in addition the extra costs of superintendence and inspection. Justice Brandeis, writing for a unanimous court, held that "[t]here is no reason why parties competent to contract may not agree that certain elements of damage difficult to estimate shall be covered by a provision for liquidated damages and that other elements shall be ascertained in the usual manner." In effect the Court allowed the parties to liquidate the plaintiff's expectancy interest but retained the right to determine the plaintiff's reasonable expenses incurred by the defendant's breach.

Two recent cases reflect the difficulty in applying the principle espoused in *Hathaway*. In *Hillsborough County Aviation Authority v. Cone Brothers Contracting Co.*, a Florida appellate court reversed a lower court decision which denied the plaintiff any recovery for actual damages, and instead awarded the liquidated damages for the defendant's delay in completion of subcontract work at an airport. Citing *Hathaway* as authority, the appellate court found that the two contract provisions regarding damages for delay in completion, one for liquidated damages and the other imposing liability for any "additional costs," were not incompatible but, rather, covered different elements of damage. The court concluded that the "additional costs" were not incompatible but, rather, covered different elements of damage.

132. Corbin, supra note 6. § 1061, at 354.
133. 249 U.S. 460 (1919).
134. Id. at 464.
135. This term is used by Dobbs to identify one of the different elements of damages The expectancy interest refers to the "benefit of the bargain" lost to the plaintiff as a result of the defendant's breach. Dobbs, supra note 6. § 12.1, at 788.
138. Id. at 621.
referred to payments which the plaintiff was obligated to make to other subcontractors for losses attributable to the defendant's delay.139 However, this was not made clear in the written contract which stated that "[the contractor] shall be liable for additional costs, if any, which are incurred by the Owner because of the failure of the Contractor to complete such work within such time limits."140 It should be noted that this is significantly different from the express language in Hathaway differentiating between exactly which elements were covered by the liquidated damages provision and which the plaintiff must actually prove.

In the second recent case based on Hathaway, a New Jersey appellate court allowed a landlord to recover liquidated damages against tenants who wrongfully refused to take possession.141 The court stated that "the fact that . . . the contract gave plaintiff the additional right to seek general damages in the event of a breach by the tenant [did not] turn [the provision stipulating damages] into a penalty clause."142 The court concluded that the plaintiff's right to seek actual damages was not an issue in the case because the plaintiff was only seeking to enforce the liquidated damages provision.143 This is clearly contrary to the general rule that provisions which stipulate damages but allow the injured party to seek additional damages as he may establish are unenforceable.

The dissenting opinion argued that the liquidated damages clause was not valid because to find otherwise "would be inconsistent with the view that the parties adjusted in advance the damages which might arise by any breach of contract . . . ."144 The dissent further stated that Hathaway is factually distinguishable and concluded that "[s]ince it appears that the parties did not intend that retention of the security deposit would constitute the sole damages recoverable by the lessor, [the provision] cannot be construed as a liquidated damage clause."145

The majority seems to have missed an important point in the Hathaway decision—that the elements of damage not covered by the liquidated damages provision were clearly expressed in the contract. The contract in Hathaway expressly stated that the defendant was liable for the expenses of inspection and superintendence in addition to liquidated damages. In contrast, the contract in this case made no such expression and the majority was unable to interpret from the facts which elements of damage were covered by the liquidated damages provision and which were left for the court to determine.

Both of these opinions highlight the difficulty in applying the principle
introduced in Hathaway. If there is any doubt that the provision stipulating the damages covers the same elements as those which the plaintiff is allowed to prove, then the court should hold the provision void as a penalty.\textsuperscript{146}

The second half of the general rule concerning the exclusiveness of a liquidated damages clause as a remedy\textsuperscript{147} provides that such a clause will not per se restrict an injured party's right to equitable relief. It is generally held that a valid liquidated damages clause does not prevent an action for specific performance or injunction to restrain a continuing breach.\textsuperscript{148} Professors Calamari and Perillo state the rule as follows:

[I]f the criteria for equitable relief are met, the court will issue a decree for specific performance. The fact that damages have been liquidated does not give the party who has promised to pay liquidated damages an option to perform the basic agreement or to pay damages at his discretion.\textsuperscript{149}

However, this proposition has not always been widely accepted. It may be argued that this rule is inconsistent with a basic requirement for equitable jurisdiction—the inadequacy of the legal remedy.\textsuperscript{150} Where the parties have agreed to a stipulated sum as a remedy and the court finds it enforceable as a valid liquidated damages clause, then it would seem that the parties have an adequate legal remedy and there would be no basis for equitable jurisdiction.\textsuperscript{151} While this theory has never had majority status in this country, it found acceptance in a number of jurisdictions during the late nineteenth and early twentieth centuries.\textsuperscript{152} In 1892 the Connecticut Supreme Court followed this theory to its logical conclusion by differentiating between liquidated damages clauses and penalties when it stated:

If the defendant has agreed not to [breach the contract] under a penalty of $1,000 for a breach, equity will restrain him; for a penalty is merely a security for the performance of the contract, and is not the price for doing what a man has expressly

\textsuperscript{146} Other than these few cases which have interpreted the Supreme Court decision in Hathaway in too broad a manner, the general rule that a liquidated damages clause precludes recovery of actual damages is consistently followed. Whether this rule continues to be strictly applied under the Uniform Commercial Code is questionable.

\textsuperscript{147} See note 121 supra and accompanying text.

\textsuperscript{148} See 5A A. Corbin, Contracts § 1213 (1964); McCormick, supra note 3, § 152.

\textsuperscript{149} Calamari & Perillo, supra note 3, § 234.

\textsuperscript{150} H. McClintock, Equity § 43 (2d ed. 1948).

\textsuperscript{151} "The reason [for] this rule is, that the parties have formally agreed upon the compensation—have assessed the damages—and have thereby declared that an appeal to equity is unnecessary, since they have made the legal relief adequate." J. Pomeroy, Specific Performance of Contracts § 50 (3d ed. 1926).

\textsuperscript{152} Clark v. Rosario Mining & Milling Co., 176 F. 180 (9th Cir.), cert. denied, 218 U.S. 671 (1910); Dills v. Doebler, 62 Conn. 366, 26 A. 398 (1892); Holltorf v. Walker, 121 So. 553 (Fla. 1929); Bartholomae & Roessing Brewing & Malting Co. v. Modzelewski, 269 Ill. 539, 109 N.E. 1058 (1915), overruled, Bauer v. Sawyer, 8 Ill. 2d 351, 134 N.E.2d 329 (1956), Martin v. Murphy, 129 Ind. 464, 28 N.E. 1118 (1891); Stafford v. Shortreed, 62 Iowa 524, 17 N.W. 756 (1883); Fisher v. Shaw, 42 Me. 32, 41 (1856); Hahn v. Concordia Soc'y, 42 Md. 460 (1875).

It is interesting to note that Louisiana still follows this rule today. Termplan Arabi, Inc. v. Carollo, 299 So. 2d 831 (La. Ct. App. 1974).
agreed not to do. But if on the other hand the true interpretation of the agreement is that the \([\$1000]\) was intended to be liquidated damages, then the court should not interfere by injunction, because the plaintiff has his complete remedy at law . . . .\(^{153}\)

Despite the theoretical merit of this argument, it has given way to the more practical consideration that such an interpretation allows the defaulting party to lawfully avoid his contractual obligation by simply paying the stipulated sum. This, it is feared, is usually not intended by the parties agreeing to the liquidated damages clause. For this reason the short-lived minority rule gave way to the uniform holding that specific performance or injunction are possible remedies for breach of contract even though a legal remedy is available in the form of a liquidated damages clause.

However, even under this now well-established rule, the issue of equitable relief in cases involving contracts with a liquidated damages provision remains important today. While no one seriously questions whether there is equitable jurisdiction over such cases, there is often a difficult factual question of whether the parties intended the defaulting party to have the privilege of not performing by paying the stipulated amount or whether this sum was merely a provision to avoid the necessity of proof of damages should the injured party decide to seek them.\(^{154}\) If the parties did intend to agree to an option contract, then equitable relief would not be available to the injured party because payment of the stipulated sum would constitute fulfillment of the contract.\(^{155}\)

\(^{153}\) Dills v. Doeblcr, 62 Conn. 366, 368-69, 26 A. 398, 399 (1892).

\(^{154}\) People v. Ocean Shore R.R., 90 Cal. App. 2d 464, 472-73, 203 P.2d 579, 584-85 (1st Dist. 1949), overruled on other grounds, County of San Diego v. Miller, 13 Cal. 3d 684, 532 P.2d 139, 119 Cal. Rptr. 491 (1975) (en banc) (parties intended liquidated damages clause to bar specific performance of a contract for the sale of land); Dillard Homes, Inc. v. Carroll, 152 So. 2d 738, 741 (Fla. Dist. Ct. App. 1963) (parties intended liquidated damages provision to be exclusive remedy for breach of contract for sale of land); Rootberg v. Richard J. Brown Assoc., Inc., 14 Ill. App. 3d 301, 302 N.E.2d 467 (1st Dist. 1973) (case remanded to determine whether liquidated damages clause prevented vendor from suing for specific performance of a real estate contract); Duckwall v. Rees, 119 Ind. App. 474, 479-80, 86 N.E.2d 460, 462-63 (1949) (parties intended liquidated damages clause to bar specific performance); Armstrong v. Stiffler, 189 Md. 630, 634-35, 56 A.2d 808, 810 (1948) (liquidated damages clause was not intended to prevent buyers from specifically enforcing a contract for the sale of a dairy company); Novelty Blas Binding Co. v. Shevrin, 342 Mass. 714, 715 N.E.2d 374 (1961) (liquidated damages provision was not intended to preclude employers from suing to enjoin a previous employee from competing); Rubinstein v. Rubinstein, 23 N.Y.2d 293, 244 N.E.2d 49, 296 N.Y.S.2d 354 (1968) (liquidated damages provision was not intended to bar specific performance of a contract for the sale of a business); Diamond Match Co. v. Roeber, 106 N.Y. 473, 486, 13 N.E. 419, 424 (1887) (liquidated damages clause did not prevent a purchaser of a business from obtaining an injunction restraining the seller from competing); Moritz v. Broadfoot, 35 Wis. 2d 343, 151 N.W.2d 142 (1967) (liquidated damages provision was not intended to bar vendor's action for specific performance of a real estate contract).

\(^{155}\) Whether a liquidated damages clause is interpreted as an alternative promise is irrelevant in a normal action for damages because, in an action for breach of an option contract in which one has the option of paying a sum of money in lieu of performance, the courts will enforce that option to pay money. Thus under either interpretation the injured party will receive only the
LIQUIDATED DAMAGES

1977

tion are available remedies remains open even though the presence of a liquidated damages clause in a contract does not per se preclude such remedies.

However, the issue of the parties' intent has proved difficult to resolve. Too often the parties have not given adequate consideration to the question of whether or not the liquidated damages provision should be available to the promisor to avoid his obligation to perform under the contract. Generally, parties think primarily in terms of performance rather than breach at the time the contract is formed. Despite this drawback, it is the parties' intention that controls and it must "be deduced from the whole instrument and the circumstances . . .". In order to determine the parties' intentions without much circumstantial evidence available, the courts are forced to scrutinize each word in the actual liquidated damages clause as an aid in resolving the issue. Contracts for the sale of real estate provide a good example of this.

Typical real estate contracts provide for a forfeiture of a deposit if the buyer breaches the contract. Most courts have little difficulty in finding this to be a valid liquidated damages clause, but are less sure of the proper result when...

stipulated amount; see, e.g., Pennsylvania Re-Treading Tire Co. v Goldberg, 305 Ill. 54, 137 N.E. 81 (1922), discussed in 32 Yale L.J. 618 (1923).

However, the issue has arisen in two other circumstances. The first involves the Statute of Frauds where the courts have been faced with the issue of whether a liquidated damages provision in an oral contract is merely a device to stipulate damages in the event of a breach of an unenforceable oral promise or is itself an alternative enforceable promise; see, e.g., Chandler v. Doran Co., 44 Wash. 2d 396, 267 P.2d 907 (1954).

The other area where the issue is raised is in determining for tax purposes the exact time a purchaser gains equitable title under a contract with a liquidated damages provision. If the provision is an alternative promise, then the purchaser does not gain title until the option to purchase is exercised. But if the device is intended solely to stipulate damages, then the purchaser takes title when the contract is agreed to. Commissioner v. Stuart, 300 F.2d 872 (3d Cir. 1962); Fletcher v. United States, 303 F. Supp. 583 (N.D. Ind. 1967), aff'd, 436 F.2d 413 (7th Cir. 1971).

156. Corbin, supra note 6, § 1058, at 339.


158. One factor sometimes given consideration in determining the intention of the parties is which party benefited by the inclusion of the liquidated damages provision in the contract. If the provision was inserted for the benefit of the injured party, then the clause should not be interpreted as giving the defaulting party the option of not performing. But if the clause was inserted for the benefit of the defaulting party, then such an interpretation would be more appropriate. In many cases, a finding of who bargained for the insertion of a liquidated damages clause, rather than an analysis of the particular words used, will give the court a good indication of whether the parties intended the clause to be an alternative promise; see, e.g., Stewart v. Griffith, 217 U.S. 323, 329 (1910); Fletcher v. United States, 303 F. Supp. 583, 589 (N.D. Ind. 1967), aff'd, 436 F.2d 413 (7th Cir. 1971); Save-Way Drug, Inc. v. Standard Inv. Co., 5 Wash. App. 726, 729, 490 P.2d 1342, 1344 (1971).

the seller sues for specific performance and the buyer defends by arguing that the
liquidated damages clause represents the seller's exclusive remedy under
the contract. In such situations the courts look to the particular wording of
the liquidated damages clause to determine the parties' intention.

One type of real estate contract has been interpreted to be an option
contract with alternative promises. These contracts use language such as
"[u]pon the purchaser's failure to take title as herein provided . . . the
contract shall be deemed cancelled . . . and the amount paid hereunder shall
belong to the seller as liquidated damages." The word "cancelled" is
usually found to be sufficient evidence that the parties intended the buyer to
have the right to refuse title.

In T.S.E. Building Corp. v. Andreiev, the above clause was expanded to
also include the following language: "‘and/or the Seller may bring such legal
proceedings as will enforce its right hereunder.'" Despite this language the
court concluded that the seller did not have a right to specific performance.
The court reasoned that the wording, "the contract shall be automatically
cancelled," meant that the parties intended that the seller not be able to sue
to enforce the terms of the contract. Consequently the additional language was
of no effect because after the purchaser refused to take title the contract was
cancelled. Real estate contracts using similar language such as "‘without
any further liability [on the part of the purchaser] of any kind whatso-
ever,' " ‘without further liability on the part of either of the parties
hereeto,' " or " ‘the parties . . . shall be relieved of all obligations under this
instrument' " in connection with the buyer's forfeiture of deposit have been
held to preclude specific performance.

However, it is generally held that in the absence of such language, specific
performance is available to the seller. The mere presence of a liquidated
damages provision is not intended to give the purchaser the privilege of not
performing by paying the stipulated sum but rather "to help secure perfor-

— Ind. App. —, 330 N.E.2d 362, 366 (1st Dist. 1975) (clause held to be a penalty because damages
difficult to estimate).

160. Polo Field Park, Inc. v. Chartock, 3 Misc. 2d 427, 430, 154 N.Y.S.2d 735, 739 (Nassau
County Ct. 1956); accord, Deborah Homes, Inc. v. Firestone, 135 N.Y.S.2d 289, 291 (Sup. Ct
Div. 1971) (provision in a contract which provided that ‘[the deposit] shall be forfeited to seller
as liquidated damages and this contract . . . shall be of no further binding effect' was not
sufficient to bar specific performance). Id. at 728, 490 P.2d at 1343.


162. Id., 268 N.Y.S.2d at 623.

163. Id. at 742, 268 N.Y.S.2d at 623.

164. In re Tatnall, 102 N.J. Eq. 445, 446, 141 A. 174, 175 (1928), aff'd, 104 N.J. Eq. 486,
146 A. 918 (1929).

N.Y.S. 678, 679 (1st Dep't 1933) (emphasis omitted).


mance and to avoid litigation as to quantum of damages."^{168} Many courts
start with a presumption that this is the intent of the parties and consequently
persuasive evidence is needed to rebut such a presumption. This is reflected in
a recent Illinois appellate court case^{169} where the seller tried to sue for specific
performance. The contract sued upon contained a liquidated damage provi-
sion which included a sentence specifically giving the seller the right to sue for
specific performance. Despite the fact that this sentence had been lined out
and the deletion was initialed by the seller, the court remanded the cause for
determination of whether, by the deletion of the sentence, the parties intended
to alter "the natural interpretation of the contract."^{170} This holding is
indicative of the heavy burden many courts impose on the party defending a
suit for specific performance on the grounds that a liquidated damages clause
provides the exclusive remedy.

It may be concluded that the law in this area is quite complex. Despite the
simplicity of the general rule that a liquidated damages provision precludes
recovery of actual damages but does not affect a plaintiff's right to equitable
relief, there are numerous examples of cases which reach opposite conclu-
sions. Parties have been allowed to recover actual damages where only certain
elements of the total damages were liquidated^{171} and parties have been denied
equitable remedies where the defendant has been able to show that the true
intention of the parties to the contract was that payment of the liquidated
damages would absolve the defaulting party of further liability.^{172} This law
seemed fairly well settled until the Uniform Commercial Code was applied to
such cases and then the validity of all the pre-Code law was put into
jeopardy.

B. Exclusiveness under UCC Section 2-719(1)(b)

Despite the difficulty in determining exclusiveness of a liquidated damages
clause as a remedy under the common law, the UCC has further complicated
the issue. Section 2-719(1) provides that:

Subject to the provisions of subsections (2) and (3) of this section and of the preceeding
section on liquidation and limitation of damages,

(a) the agreement may provide for remedies in addition to or in substitution for those
provided in this Article . . . and

(b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be
exclusive, in which case it is the sole remedy.^{173}

The official comment on this section states:

Subsection (1)(b) creates a presumption that clauses prescribing remedies are cumula-

170. Id. at 304, 302 N.E.2d at 470.
171. See notes 131-46 supra and accompanying text.
172. See notes 154-70 supra and accompanying text.
173. UCC § 2-719(1).
tive rather than exclusive. If the parties intend the term to describe the sole remedy under the contract, this must be clearly expressed.\textsuperscript{174}

This section puts the issue in a new light by focusing solely on whether the parties expressly agreed that the liquidated damages clause be the exclusive remedy. This change from the common law raises two questions: (1) whether an injured party may recover actual damages if the parties do not expressly agree that the clause will provide the exclusive remedy and (2) whether section 2-719(1)(b) permits an injured party to pursue equitable remedies anytime the parties do not expressly agree that the clause represents the exclusive remedy. Both of these questions recently have been addressed by courts, but the answers remain inconclusive.

In \textit{Dow Corning Corp. v. Capitol Aviation, Inc.},\textsuperscript{175} the Seventh Circuit Court of Appeals reversed a district court decision which had allowed a purchaser of a new type of airplane to recover his actual damages despite a provision in the contract which purportedly limited his remedy for delay in delivery to cancellation of the contract and a return of his deposit. The circuit court held this provision was a valid liquidated damages clause and therefore precluded recovery of actual damages and stated:

\begin{quote}
The trial court pointed out that Sec. 2-719(1)(b) of the Code provides that a remedy as provided is optional unless it is "expressly agreed to be exclusive." It is true that nowhere does the clause use the word exclusive, but the clear import is that there shall be no remedy other than the return of the deposit. . . . To hold otherwise would be to introduce a new requirement that certain words be used to express the intent of the parties lest they later be found not to have limited their remedies.\textsuperscript{176}
\end{quote}

The court found that the provision which stated that the manufacturer would not be liable for any failure or delay in making delivery beyond the return of the purchaser's deposit was sufficient to meet the "expressly agreed" requirement of section 2-719(1)(b). \textit{Dow Corning} has come to stand for the principle that a remedy will be regarded as exclusive "when that is the reasonable construction of the contract and the fact that the word 'exclusive' is not employed by the parties does not require the conclusion that the remedies specified are not conclusive."\textsuperscript{177}

In \textit{J.D. Pavlak, Ltd. v. William Davies Co.}\textsuperscript{178} an Illinois appellate court found that a liquidated damages clause was the exclusive remedy based on the principle in \textit{Dow Corning}. In \textit{J.D. Pavlak} the contract for the sale of meat contained a formula for determining damages for the seller's delivery of meat with more than 15 percent fat content.\textsuperscript{179} In addition to finding that the words of the provision would be meaningless if the provision was not held to be exclusive, the court reinforced its decision by looking at the prior dealings

\begin{footnotes}
\item[174] UCC § 2-719, Comment 2.
\item[175] 411 F.2d 622 (7th Cir. 1969).
\item[176] Id. at 626. The court also held that the lower court erred in finding the liquidated damages clause unreasonably small and therefore void as unconscionable. Id. at 627.
\item[178] 40 Ill. App. 3d 1, 351 N.E.2d 243 (1st Dist. 1976).
\item[179] Id. at 2, 351 N.E.2d at 245.
\end{footnotes}
between the parties. In a previous contract the same parties had used the same formula as a liquidated damages provision to satisfactorily settle the damages for the seller's minor breach in selling meat with excess fat. The court concluded that "in light of the contract language and these past dealings" the parties intended the clause to be the exclusive remedy for the seller's breach. It should be noted that both Dow Corning and J.D. Pavlak have not literally applied section 2-719(1)(b) in cases with liquidated damages clauses, but rather have tried to find the reasonable construction of the contract. If these cases had been decided under the common law, there would not have been any discussion of the parties' intention or whether the liquidated damages clause was expressly made the exclusive remedy. But rather, if the court had found the liquidated damages clause to be valid and enforceable, rather than a penalty, then by definition, the injured party would be precluded from recovering his actual damages.

The question of how section 2-719(1)(b) should be applied when the injured party is seeking an equitable remedy was addressed in Carolinas Cotton Growers Association v. Arnette where a federal district court allowed the plaintiff to specifically enforce a contract for the sale of cotton despite the presence of a liquidated damages clause. The contracts involved were "forward contracts" which are made in the spring before the cotton is planted and establish the price to be paid in the fall when the cotton is harvested. Between the spring and fall of 1973 the price of domestic cotton rose almost 200 percent and consequently the defendant sought to pay the liquidated damages and avoid his obligation under the contract. The court held that the liquidated damages provision did "not allow the defendants to pay the liquidated damages and void the contracts in question." It based its decision on section 2-719(1)(b) and found that "[t]here is no statement in the present contract that the paragraph regarding liquidated damages is intended to be the exclusive or only remedy of the plaintiff in the event of breach." This decision implies that it is not necessary to look at the intention of the parties or the surrounding circumstances, but rather specific performance can only be precluded by a liquidated damages provision that contains express language that it is the exclusive remedy. This highly artificial test is a substantial departure from the common law which sought to ascertain the intention of the parties when determining whether a liquidated damages provision gave the party who agreed to pay the liquidated sum the privilege of not performing. In addition, Carolinas Cotton Growers leaves a disturbing question of whether the plaintiff could have recovered his actual damages since the court found that the liquidated damage clause was not the exclusive remedy under section

180. Id. at 3-4, 351 N.E.2d at 245-46.
181. Id. at 4, 351 N.E.2d at 246.
183. Id. at 66.
184. Id. at 70.
185. Id.
186. See notes 154-55 supra and accompanying text.
2-719(1)(b). In short, it was unclear whether the word "remedy" in section 2-719(1)(b) referred to actual damages, as in Dow Corning and J.D. Pavlak, or to equitable remedies, as in Carolinas Cotton Growers, or both.

This issue was squarely faced in Ray Farmers Union Elevator Co. v. Weyrauch, in which the North Dakota Supreme Court affirmed the granting of defendant's motion for summary judgment in plaintiff's favor based upon a liquidated damages clause. The court held that the plaintiff could not recover his actual damages despite the fact that the liquidated damages clause was not made expressly exclusive.

One year before the decision in Weyrauch, the North Dakota Supreme Court had held in Farmers Union Grain Terminal Association v. Nelson that a liquidated damages clause prevented the injured party from recovering actual damages because the liquidated damage provision "appears clearly intended as an exclusive means of computing the loss in the event of failure to deliver." Thus, by analyzing the case under section 2-719(1)(b), the court must have concluded that a provision found to be a valid liquidated damages clause under section 2-718 did not necessarily preclude the plaintiff from recovering actual damages. This decision seemed to follow Dow Corning and J.D. Pavlak in holding that 2-719(1)(b) applies to actual damages.

But when the court was given another chance to decide the issue in Weyrauch, the majority of the court changed its position and held that actual damages were not an alternative remedy under 2-719(1)(b). The court stated: The alternatives argued by the elevator company are not alternative remedies within the portent of [section 2-719(1)(b)], but are alternative forms of the same remedy—damages. Any other conclusion would negate the purpose of [section 2-718(1)].

The court added that they were not deciding "whether a liquidated damage

---

187. In a casenote analyzing Carolinas Cotton Growers the author states that "[t]here is no compelling reason to believe that section 2-719(1)(b) alters [the rule that a valid liquidated damages clause precludes the injured party from recovering actual damages]; it simply makes clear that non-damage remedies are not precluded." 53 N.C.L. Rev. 579, 581-82 (1975). This interpretation suggests that the analysis of section 2-719(1)(b) in Dow Corning and J.D Pavlak was unnecessary and the courts should simply follow the pre-Code law when the injured party wants to recover actual damages rather than the stipulated sum.

However, in a footnote to the sentence quoted above, the author equivocates when he stated: "An argument could be made that section 2-719(1)(b) does not preclude damage remedies either. . . . Assuming no such express language [making the liquidated damages clause the exclusive remedy], if an injured party chooses not to seek the contract remedy, in this case liquidated damages, he should be able to seek any available alternative remedy, including actual damages . . . . Holding that he may not seek actual damages in effect would mean that the liquidated damages clause is exclusive." Id. at 582 n.16.

This footnote conforms to the analysis in Dow Corning and J.D. Pavlak which applied § 2-719(1)(b) to suits in which the injured party sought actual damages despite the existence of a liquidated damages clause.

188. 238 N.W.2d 47 (N.D. 1975).
189. 223 N.W.2d 494 (N.D. 1974).
190. Id. at 498.
191. 238 N.W.2d at 49 (footnote omitted).
clause would be the sole remedy in a case where the alternative remedies urged are specific performance . . . , or injunction, rescission, or other judicial remedy." Thus the majority held that the Code did not change pre-Code law which precluded recovery of actual damages when there was a valid liquidated damages clause despite the absence of an express agreement making it the exclusive remedy.

The dissenting opinion argued that the majority was ignoring the plain meaning of the statute. Justice Vogel disagreed with the majority's statement that damages is a single remedy and argued that the Code views damages as "a cluster of remedies" by looking at sections 2-708 through 2-721 which identify "about a dozen different remedies, including many different kinds of damages as well as specific performance and injunction." He concluded that the court was correct in its decision of the previous year in Nelson where a liquidated damages clause was held to be the exclusive remedy "only after a full-scale trial had been held and all the facts were before us." According to the dissent, the majority "stands the statute on its head" by holding that a liquidated damages clause is exclusive as a matter of law.

Weyrauch is the first case to clearly analyze the difficult problems of reconciling sections 2-718(1) and 2-719(1)(b). The majority opinion interpreted the statute as following the common law. It should be realized that the majority made clear that the result in Dow Corning and J.D. Pavlak could have been reached without reference to exclusiveness under section 2-719(1)(b), yet the dissent is clearly supported by a literal reading of the statute. Despite the fact that the majority has freely interpreted the language of the section, the result seems more correct than that reached by the dissent.

Another issue is presented by the language in the official comment following section 2-719(1)(b) which provides that this section "creates a presumption that clauses prescribing remedies are cumulative." The question has been raised whether this allows an injured party to recover liquidated damages and in addition sue for specific performance. The common law clearly resolved the issue in the negative—the injured party had the alternative of recovering the liquidated damages or suing for equitable relief, but he was not entitled to both. Thus under the common law the enforcement of a liquidated damages provision and equitable relief were mutually exclusive remedies. The use of the word "cumulative" in the official comment to section 2-719(1)(b) seems to cast doubt on the common law rules.

192. Id.
193. Id. at 51-52.
194. Id. at 51.
195. Id.
196. Id. at 52.
197. Id. at 51.
The issue was presented in *Miller Yacht Sales, Inc. v. Scott* where a Florida appellate court concluded that despite the use of the word "cumulative," the Code really meant that the liquidated damages clause was an *optional* remedy. The court held that "[the plaintiff's] exercising of its option to retain the deposit as liquidated damages precluded it from obtaining specific performance..." Thus the court interpreted the comment to the Code as merely codifying the common law rule despite any literal meaning to the contrary.

As it has been interpreted, section 2-719(1)(b) has not radically changed pre-Code law. If the "reasonable construction" test of Dow Corning, the majority in Weyrauch, and the prohibition against double recovery in Scott are all followed, then the Code will substantially conform to pre-Code law regarding the exclusiveness of a liquidated damages clause as a remedy. However, it should be realized that these three interpretations are not the result of a literal reading of the Code.

IV. CONCLUSION

The Uniform Commercial Code has offered a new approach to the issues presented when a liquidated damages clause is included in a contract. However, it has not resulted in any radical departures from pre-Code law.

In distinguishing between a liquidated damages clause and a penalty, section 2-718(1) generally has followed pre-Code law with two significant exceptions—(1) failing to include the intention of the parties to the contract as a criterion for analyzing provisions attempting to liquidate damages and (2) the inclusion of actual harm as an alternative standard for judging the reasonableness of the stipulated damages. The impact of these changes, however, remains to be seen. Nevertheless certain results have been predicted such as repealing the rule against a single liquidated sum covering multiple breaches.

The Code could have been interpreted as a radical change from pre-Code law regarding liquidated damages as the exclusive remedy. However, it now appears that the courts will interpret section 2-719(1)(b) to conform substantially to the common law principles governing this area.

Generally, it must be concluded that the Code has not provided a statute which will clarify this unusually confusing and complex area of law. As Professor Crowley stated:

The statutory provisions relating to liquidated damages in the Uniform Commercial Code have not reduced the sense of confusion... Rather in those contracts subject to the Code, the... provisions appear to have increased the confusion.

199. 311 So. 2d 762 (Fla. Dist. Ct. App. 1975), cert. denied, 328 So. 2d 843 (Fla. 1976)
200. Id. at 763.
201. See note 28 supra and accompanying text.
202. See notes 29-32 supra and accompanying text.
203. See notes 63-65 supra and accompanying text.
204. See notes 191-92, 199-200 supra and accompanying text.
205. Crowley, supra note 9. at 78.
This statement accurately reflects the conflicts that have developed under the Code. However, this need not be the final result. The Code has the potential to be a vehicle for easing the restrictions on liquidated damages provisions. In contracts which are genuinely bargained for, rather than mass-produced adhesion contracts, there is no sound policy reason for denying the parties their freedom to contract. At the very least it is hoped that the second and third criteria will be limited in their application so as not to invalidate contracts bargained for in good faith. Section 2-718 provides an excellent opportunity for the law to admit that in many cases the parties themselves are just as competent as courts or juries to determine the fair compensation for breach of contract.

William S. Harwood

206. Dobbs, supra note 6, § 12.5, at 823.