LIQUIDATED DAMAGES UNDER THE
UNIFORM COMMERCIAL CODE

by
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I. INTRODUCTION
A. Scope Note

A liquidated damage clause, quite simply, attempts to stipulate or make certain the amount of damages that will be recoverable in the event of breach. Parties should use a liquidated damage clause in drafting a contract whenever it appears, looking forward, that a breach might cause damage that will be speculative in amount or otherwise difficult to prove. When the damages from a breach will likely be speculative in amount, a properly drafted liquidated damage clause will avoid or reduce the expense and difficulty of proving damages and will make certain that the aggrieved party is not left without remedy. A liquidated damage clause, as its title suggests, will also liquidate damages at the time of breach so that prejudgment interest will begin to run immediately against the breaching party.1 A liquidated damage provision may function, as a practical matter, to deter breach in situations where one party might otherwise feel comfortable in breaching because of a perceived inability of the other to prove damages.

Although the Code permits the parties to liquidate damages, that permission cannot be exercised so as to violate the overriding principle of compensation. Historically, this principle prohibits the parties from providing in the contract for the imposition of a penalty penal damages upon breach.2 Properly construed, a valid liquidated damage provision, as opposed to a penalty clause, does not allocate risk except to the extent that the provision imposes on the party to be charged the obligation to pay uncertain damages. Despite the broad freedom of contract principles embodied in the Code,3 section 1-106 forbids that “penal damages may be had except as specifically provided

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1. See Dunbar, Drafting the Liquidated Damage Clause—When and How, 20 OHIO ST. L.J. 221, 231-32 (1959), for a listing of various advantages of liquidated damage clauses.


3. See generally Sweet, Liquidated Damages in California, 60 CALIF. L. REV. 84 (1972) (discusses policy considerations and trends in party autonomy). Section 1-102(3) provides:
in this Act or by other rule of law."

Liquidated damage clauses are readily distinguishable in the abstract from penalty clauses. A penalty clause functions to coerce performance rather than to estimate damages. Liquidated damage provisions under the Code structure must also be distinguished from clauses limiting or excluding remedies and damages. Section 2-718(1) governs the former and section 2-719 governs the latter. A remedy limitation provision, quite clearly, acts as a risk allocator because it restricts the liability of the breaching party. A liquidated damage provision, on the other hand, does not attempt to restrict liability, but merely attempts to estimate the damages that are or will likely be caused by a breach. Nevertheless, many Code cases have confusingly referred to section 2-718 on liquidated damages when discussing a remedy limitation provision that section 2-719 would properly govern. The cause of this confusion in analysis no doubt centers around the fact that section 2-719 expressly subjects itself to the provisions on liquidated damage clauses in section 2-718. Further, as a practical matter, a liquidated damage provision is a type of exclusive, limited remedy. When a liquidated damage provision is properly applicable, the aggrieved party is relegated to it for his remedy and may not pursue other remedies under the Code. The occasional confusion by the courts in referring to section 2-718 when analyzing general remedy limitation provisions has not to date affected the correctness of the courts' results. Ultimately, the efficacy of the provision turns on the stan-

The effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act and except that the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.

U.C.C. § 1-102(3) (1978).
7. Section 2-719 of the Uniform Commercial Code begins with the following: "Subject to the provisions of subsections (2) and (3) of this section and of the preceding section on liquidation and limitation of damages. . . ." U.C.C. § 2-719(1) (1978).
9. See 5 CORBIN ON CONTRACTS § 1061 (1964) [hereinafter CORBIN].
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Standards provided by section 2-719.¹⁰

Historically, the courts have had great difficulty providing and applying sensible standards for determining the validity of liquidated damage provisions. As will be seen, section 2-718 is likely to do little to abate this confusion.

B. The Statute

Section 2-718(1) of the Commercial Code 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.¹¹

C. Historical Background

The genesis of standards against which to judge the efficacy of liquidated damage provisions is the early English reaction, first in equity and then at law, against the enforcement of penal bonds in cases in which no actual damages were suffered.¹² Over time this negative reaction spread to all types of clauses that provided for penalties upon breach of contract. In this country, a rule evolved that contractual provisions stipulating the amount of recovery upon breach would be allowed only when the parties reasonably attempted to pre-estimate damages that might result from the breach. Although the courts made it clear they would not disregard the general principles of freedom of contract nor overlook the importance of the intent of the parties, the rule was firmly established that courts would enforce a liquidated damage provision only when it represented a fair estimate of the harm likely to result from the breach.¹³

In the 1930s, the Restatement of Contracts suggested the following rule structure:

An agreement, made in advance of breach, fixing the damages therefor is not enforceable as a contract and does not affect the damages recoverable for the breach, unless


¹¹ See 5 CORBIN, supra note 9, § 1056.

(a) the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach, and

(b) the harm that is caused by the breach is one that is incapable or very difficult of accurate estimation.\(^{14}\)

The Restatement provision came to be widely followed by the courts in virtually every jurisdiction. The majority of the courts interpreted the provision to focus on the time of the making of the contract.\(^{15}\) The twofold test of the courts was: (1) whether, at the time of contracting, it appeared that the damages likely to result from breach would be uncertain in amount; and (2) whether the parties made a reasonable forecast of the amount of harm likely to be caused by the breach.\(^{16}\) Under this rule structure, the actual damages suffered were regarded as irrelevant, the focus being entirely upon the time of the contracting.\(^{17}\) The courts often said that the bright-line test was the intent of the parties.\(^{18}\) If the parties intended to make a good faith pre-estimate of uncertain damages, courts would enforce the clause.\(^{19}\) If the parties intended to provide for a penalty, courts would invalidate the clause.\(^{20}\) Professor Corbin was quick to point out that this reasoning was wholly circular.\(^{21}\) In the context of liquidated damage provisions, "intent of the parties" provided nothing more than a means for squaring doctrine with result.\(^{22}\) Regardless of the language used by the parties in the contract, if the courts determined that the parties had made a legitimate pre-estimate of uncertain damages, they enforced the provision.\(^{23}\) If the courts determined otherwise, they did not.\(^{24}\) The test, then, was truly twofold and the actual intent of the parties was irrelevant.

Under the reasonable forecast or pre-estimate test, many courts held that actual damages were irrelevant.\(^{25}\) Even in cases in which no actual damages were suffered or in which the liquidated damage provision was grossly disproportionate to actual damages, the agreed clause was enforced.\(^{26}\) Under this view, courts would not admit evidence of actual damages into the trial

\(^{14}\) **Restatement of Contracts** § 339(1) (1932).

\(^{15}\) See United States v. J.D. Street & Co., 151 F. Supp. 469 (E.D. Mo. 1957); Byron Jackson Co. v. United States, 35 F. Supp. 665 (S.D. Cal. 1940); Norwalk Door Closer Co. v. Eagle Lock & Screw Co., 153 Conn. 681, 220 A.2d 263 (1966); see 5 Corbin, *supra* note 9, §§ 1059, 1060 for a collection of these cases.

\(^{16}\) See *supra* note 15.

\(^{17}\) Id.

\(^{18}\) Id.

\(^{19}\) Id.

\(^{20}\) Id.

\(^{21}\) See Dunbar, *supra* note 1, at 221.

\(^{22}\) See id. at 225; see also **Restatement of Contracts** § 339 comment b (1932). "[N]either the intention of the parties nor their expression of intention is the governing consideration. The payment promised may be a penalty, though described expressly as liquidated damages, and vice versa." *Id.*

\(^{23}\) See 5 Corbin, *supra* note 9, § 1059.

\(^{24}\) Id.

\(^{25}\) Id.

\(^{26}\) See, e.g., Frick Co. v. Rubel Corp., 62 F.2d 765 (2d Cir. 1933); Stephens v. Essex Co. Park Comm'r., 143 F. 844 (3d Cir. 1906); Wood v. Niagara Falls Paper Co., 121 F. 818 (2d Cir. 1903).
record. Over time, most courts came to reject this view and allowed evidence to show that no actual damages were suffered or that the liquidated damage provision provided for damages grossly in excess of those actually suffered. In this sense, at least, the basic principle of compensation was honored. Professor Corbin stated the theory as follows:

The probable injury that the parties had reason to foresee is a fact that largely determines the question whether they made a genuine pre-estimate of that injury; but the justice and equity of enforcement depend also upon the amount of injury that has occurred. It is to be observed that hindsight is frequently better than foresight, and that, in passing judgment upon the honesty and genuineness of the pre-estimate made by the parties, the court cannot help but be influenced by its knowledge of subsequent events.

Nevertheless, if the court concluded that the clause provided a reasonable pre-estimate of uncertain damages and that enforcement of the agreement would not be unconscionable, the court would enforce the liquidated damage clause even though actual damages were certain in amount and could be readily proved.

The irony of this rule structure is that it is premised on Restatement of Contracts section 339. The Restatement provision, read quite literally, would seem to focus much more on the actual damages suffered than on the pre-estimate of the parties. The parties must make a reasonable forecast of the injury that “is caused by the breach” and the injury must be “one that is incapable or very difficult of accurate estimation.” Accordingly, courts are required to enforce a liquidated damage provision only in cases in which actual damages do in fact turn out to be uncertain and difficult to prove. If actual damages are readily determinable, the liquidated damages provision should not be enforced. The commentary to section 339 emphatically supports this reasoning. The following unequivocal statement is made:

If the parties honestly but mistakenly suppose that a breach will cause harm that will be incapable or very difficult of accurate estimation, when in fact the breach causes no harm at all or none that is incapable of accurate estimation without difficulty, their advance agreement fixing the amount to be paid as damages for the breach is within the rule stated in subsection (1) and is not enforceable. Evidence to prove such a mistake is admissible. But if the breach has caused injury of such a character that it is incapable or very difficult of accurate estimation, an advance agreement making a reasonable forecast of its amount is enforced; and evidence, the purpose of which is to substitute an estimate by the court or jury for that made by the parties, is irrelevant.

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27. Frick Co., 62 F.2d at 767-68; Stephens, 143 F. at 844; Wood, 121 F. at 818.
29. 5 CORBIN supra note 9, § 1063, at 362-64.
30. RESTATEMENT OF CONTRACTS § 339 (1932).
31. Id. § 339 comment c; see also id. § 339, comment c, which states:
Although followed by only a minority of jurisdictions, the above analysis is more sensible. It fully supports the basic principle of contract law that the aggrieved party should be fully compensated and provides the best rule to ensure that penal clauses are not enforced. The courts should enforce a provision for liquidated damages only when the parties at the time of contracting presume that the damages at breach will be uncertain in amount and that presumption actually proves to be an accurate forecast of future events.

Parties should always obtain actual damages when they can be proved with reasonable certainty. It is difficult to understand the relish with which our courts have historically taken to focusing, except in extreme cases, entirely on the time of contracting. A desire to carry forward the intent of the parties is often expressed, along with a reluctance to undermine the utility of liquidated damage provisions by subjecting them to proof of actual damages in every case. But the intention of the parties, even under the majority rule, must have been based on a reasonable presumption that actual damages would be difficult to prove. If the court can ascertain the actual damages with reasonable certainty, then the parties were mistaken in their assumption, and the court should not enforce the agreed damages. A rule structure that limits the enforcement of liquidated damage provisions to situations involving uncertain damages not only carries forward the required intention of the parties, but also preserves the basic rule of contract damage law that a court should place an injured party in the position it would have occupied had the contract been performed.

D. Applicability in Contracts for the Sale of Goods

Regardless of whether courts have focused upon the situation at the time of contracting or upon the actual damages incurred, courts have restricted liquidated damage provisions to situations involving uncertain damages. Either the damages likely to be caused must be difficult to prove or those actually caused must be "incapable or very difficult of accurate estimation." The Code carries forward this tradition by permitting liquidated damages only as "is reasonable in the light of . . . the difficulties of proof of loss." For this reason, liquidated damage provisions are not commonly

Where the amount of loss or harm that has been caused by a breach is uncertain and difficult of estimation in money, experience has shown that the estimate of a court or jury is no more likely to be exact compensation than is the advance estimate of the parties themselves. Further, the enforcement of such agreements saves the time of courts, juries, parties, and witnesses and reduces the expense of litigation. In such cases, if it is not shown that the principle of compensation had been disregarded, the liquidation by the parties is made effective.

Id. The illustrations to § 339 appear, however, to contradict each other regarding the relevancy of actual damages. Compare id. § 339, illustration 2 with id. § 339, illustrations 3, 7.

See Stewart v. Basey, 245 S.W.2d 484 (Tex. 1952).

See Sweet, supra note 3, at 131-32.


RESTATEMENT OF CONTRACTS § 339(1)(b) (1932).

enforced in contracts for the sale of goods. Most goods sold have a readily ascertainable, established market against which to calculate damages, whether for the seller or the buyer. Accordingly, in most sale of goods cases it will be unlikely at the time of contracting that a breach will cause an injury too difficult to prove. Nor in fact will the actual injury produce uncertain damages. In one Code case, for example, the buyer breached a contract to purchase a Rolls-Royce automobile. The contract provided that the seller could retain the buyer's $5,000 deposit as liquidated damages upon the buyer's refusal to take delivery. The court refused to enforce the provision under section 2-718. The court said:

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 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.

Although an occasional Code case has enforced a provision for liquidated damages in a situation involving only general damages for standard goods, courts will usually restrict the enforcement of liquidated damage provisions to cases involving unique or specially manufactured goods, those having no established market, to situations involving delivery delays, and to situations involving special damages. The latter two categories of cases will usually involve buyers as plaintiffs, and the clause will apply either to a seller's delay in delivery or to a buyer's special damages. Sellers rarely suffer special damages that are difficult to prove. A seller's special damages will usually be incidental expenses incurred as a result of the breach.

37. See 5 CORBIN, supra note 9, § 1064; Sweet, supra note 3, at 105-08.
40. Id.
of out-of-pocket loss almost always is easy to prove. A buyer's entitlement to liquidated damages will usually occur in a commercial contract situation. Consumer-buyers do not customarily have the opportunity to negotiate for inclusion of a liquidated damage provision in their contracts.

One commentator has suggested that cases involving marketing or commodity cooperatives represent a separate category of goods cases in which liquidated damage provisions are regularly enforced. In such cases, the liquidated damage provision usually merely states that, in the event of breach, the market price of the goods at a certain date will measure the damages. Such clauses do not liquidate damages at an amount different from those that would be recoverable under the Code's market formulae in sections 2-708 and 2-713. They merely set the time for tender of performance under the contract of sale and thereby establish the time for calculating market-based damages under the applicable Code formula.

II. "CRITERIA" OF SECTION 2-718

A.Section 2-718(1): In General

Section 2-718 would appear to apply to any transaction in goods, whether a sale, lease, or bailment. Section 2-718 will have no application, of course, until a liquidated damage provision is found in the agreement. Code cases interpreting section 2-718 are sparse because liquidated damage provisions have limited applicability to goods transactions. The courts, however, have indicated a willingness to apply the statute in non-Code cases.

Section 2-718(1) apparently provides three criteria for judging the validity of a liquidated damage provision. These criteria are that the stipulated sum be reasonable in light of: (1) the anticipated or actual harm caused by the breach; (2) the difficulties of proof of loss; and (3) the difficulty of otherwise obtaining an adequate remedy. Arguably, the second sentence of the statute establishes a fourth, overarching criterion. The second sentence states: "A term fixing unreasonably large liquidated damages is void as a penalty." At least one court has found this to be a separate test that must be met to validate a liquidated damages provision.

46. See Sweet, supra note 3, at 106.
49. See supra notes 35-47 and accompanying text.
50. See supra notes 35-47 and accompanying text.
53. Id.
Whether the criteria be three or four, it seems clear that the sole test for validity under section 2-718 is reasonableness. This interpretation gives the statute its literal reading. In this respect, the “criteria” are not criteria at all, but rather are factors that the court should look to in making its judgment regarding the reasonableness of the clause.\(^{55}\) Thus, a court should not invalidate the clause merely because one or more of the factors cannot be proved in a particular case. The Official Comment supports this interpretation: “Under subsection (1) liquidated damage clauses are allowed where the amount involved is reasonable in the light of the circumstances of the case. The subsection sets forth explicitly the elements to be considered in determining the reasonableness of a liquidated damage clause.”\(^{56}\)

Section 2-718 represents a marked departure from the basic common law rules regarding liquidated damage provisions. It abandons entirely the so-called “intention of the parties” test,\(^{57}\) and it specifically allows the court to focus on the actual damages suffered in determining the reasonableness of the clause.\(^{58}\) Nevertheless, the statute is confusing in its wording and presents difficulty in its application to actual fact situations. For these reasons, it is not surprising to find courts turning to the old common law rule structure when judging the validity of liquidated provisions.\(^{59}\) The new Restatement of Contracts and the cases following its precepts may provide guidance to the courts in the future in interpreting and applying section 2-718.

**B. Restatement (Second) of Contracts**

Section 356 of Restatement (Second) of Contracts provides:

> Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty.\(^{60}\)

The commentary to the provision states the theory behind allowing parties to liquidate damages:

> The enforcement of such provisions for liquidated damages saves the time of courts, juries, parties and witnesses and reduces the expense of litigation. This is especially important if the amount in controversy is small. However, the parties to a contract are not free to provide a penalty for its breach. The central objective behind the system of contract remedies is compensatory, not punitive. Punishment of a promisor for having broken his promise has no justification on either economic or other grounds and a term providing such a penalty is unenforceable on

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\(^{56}\) U.C.C. § 2-718 comment 1 (1978).

\(^{57}\) See supra notes 18-24 and accompanying text.

\(^{58}\) See Note, supra note 34, at 871.

\(^{59}\) See supra notes 18-24 and accompanying text.

\(^{60}\) Restatement (Second) of Contracts § 356(1) (1979).
grounds of public policy. The new Restatement provision was drafted "to harmonize" with section 2-718(1) of the Code. The new Restatement, however, has dropped the "inconvenience or nonfeasibility of otherwise obtaining an adequate remedy" language of the Code. The thought presumably is that the language adds nothing and is redundant to the "difficulties of proof of loss" language in the provision.

The Restatement, then, suggests a two-factor test for determining the reasonableness of a liquidated damage provision. This test looks to (1) the anticipated or actual loss caused by the breach; and (2) the difficulty of proof of loss. These factors are not independent but rather interrelate.

The greater the difficulty either of proving that loss has occurred or of establishing its amount with the requisite certainty . . . , the easier it is to show that the amount fixed is reasonable. If the difficulty of proof of loss is great, considerable latitude is allowed in the approximation of anticipated or actual harm. If, on the other hand, the difficulty of proof of loss is slight, less latitude is allowed in that approximation. If, to take an extreme case, it is clear that no loss at all has occurred, a provision fixing a substantial sum as damages is unenforceable.

We are told by the commentary, however, to read literally in the disjunctive the first factor of reasonableness in terms of anticipated or actual harm. Courts should hold valid the clause if it is reasonable when compared to either. Thus, the sum stipulated "is reasonable to the extent that it approximates the actual loss that has resulted from the particular breach, even though it may not approximate the loss that might have been anticipated under other possible breaches." Reference is made to an illustration that supports the statement.

The commentary then attempts to address the hard case from an equitable standpoint of when the sum is reasonable in terms of the anticipated, but not the actual, harm. The commentary states that "the amount fixed is reasonable to the extent that it approximates the loss anticipated at the time of the contract, even though it may not approximate the actual loss." The commentary cites the following illustration to support the proposition:

A contracts to build a grandstand for B's race track for $1,000,000 by a specified date and to pay $1,000 a day for every day's delay in completing it. A delays completion for ten days. If $1,000 is not unreasonable in the light of the anticipated loss and the actual loss to B is difficult

61. Id. § 356 comment a.
62. Id. § 356 reporter's note; see Note, supra note 34, at 862, for a helpful, in-depth analysis of § 356.
64. Id.
66. Id. § 356 comment b.
67. Id.
68. Id.
69. Id. § 356 comment b, illustration 2.
70. Id. § 356 comment b.
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...to prove, A’s promise is not a term providing for a penalty and its enforcement is not precluded on grounds of public policy.71

The Restatement thus equivocates on the most difficult liquidated damage situation, one in which actual damages may be readily proved to be much less than the amount liquidated. This particular kind of case often produced unfair results under the common law rule structure.72 The new Restatement does not speak to this situation either in commentary or by illustration. The hope is that the courts will read the provision, and section 2-718 for that matter, so as to hold the clause invalid in such cases. The over-arching test is reasonableness and courts should read the factors of the test together. Since the second factor, difficulty of proof of loss, is entirely absent, courts should find the clause unreasonable even though it approximates the anticipated (but not actual) loss. This hope, however, may be somewhat optimistic.73

C. Judicial Interpretation of Section 2-718(1)

Section 2-718(1) is written in such a way as to allow the courts great flexibility in determining the validity of liquidated damage provisions. The sole test is reasonableness, with various factors supplied to guide a court in its determination. As with so many of the Code’s provisions, one must follow closely the case law encrustation on the statute to understand its parameters. Unfortunately, to date the cases on the whole are a sparse and uneven lot. Two highly respected courts on opposite sides of the continent have provided, a decade apart, two of the more helpful judicial interpretations.

The first court to give detailed consideration to the Code’s liquidated damage statute was the New York Court of Appeals in Equitable Lumber Corp. v. IPA Land Development Corp.74 The case involved a sale of lumber and building materials to a builder and developer. The buyer refused to pay for accepted goods, and the seller brought suit for the purchase price and attorney’s fees stipulated in the contract. The contract provided that, upon default, the buyer would be liable for attorney’s fees and that “such reasonable counsel fee is hereby agreed to be thirty (30%) per cent.”75 The trial court refused to enforce the provisions and allowed recovery of only the reasonable value of the legal services rendered.76 After a hearing, the court determined that a maximum amount of ten hours was required to handle the matter properly and awarded the seller an amount of $450 (approximately 11% of the amount received).77 On appeal, the appellate division modified the award
to $750. The court of appeals, on further appeal, held section 2-718 directly applicable to the case and stated:

At the time of contracting the attorney's fees were arguably incapable of estimation. The amount ..., would vary with the nature of the defaulting party's breach. For instance, a greater amount would be charged in the event that litigation was necessitated as opposed to settlement; and additional charges might be required for possible appellate procedures.

The court reasoned that, since section 2-718 was applicable to the case, the reasonable value of the legal services was not the appropriate measure of damages. Instead, the question was whether the stipulated amount was a reasonable estimate of anticipated harm or, alternatively, whether the stipulated amount was reasonable in terms of the actual arrangement the seller had with its attorneys. The court said:

Under both the "actual" and "anticipated" harm tests, the time expended by the attorney in obtaining collection is not necessarily the correct measure of damages, since an attorney would be expected to bill his client on a contingent fee basis. The liquidated damage provision would prove to be a reasonable pre-estimate of anticipated harm if it is related to the normal contingent fee charged by attorneys in the collection context.

With respect to the factor of "actual harm," the court said: "On the other hand, if plaintiff actually entered into a contingent fee arrangement with its attorney for 30%, then the actual harm suffered by plaintiff would be consistent with the liquidated damages provision." The court thus applied the "anticipated or actual harm" language in section 2-718 in the disjunctive. Compliance could be had by a showing of reasonableness in terms of either the anticipated or actual harm. The court expressly recognized that this was a departure from pre-Code, New York law, which focused entirely on anticipated harm. Nevertheless, the court reasoned that the clause must also pass muster under the second sentence in section 2-718(1) even if the clause was reasonable in terms of the anticipated or actual harm. The court said:

However, even if the "actual harm" test is satisfied, it is then necessary, pursuant to the second sentence of § 2-718(1), to determine whether the liquidated damages provision is so unreasonably large as to be void as a penalty. If plaintiff entered into an exorbitant fee arrangement with counsel, knowing that defendant would suffer the consequences, then the liquidated damage provision would be void as a "term fixing unreasonably large liquidated damages. The commercial practice

78. Id.
79. Id., 344 N.E.2d at 396-97, 381 N.Y.S.2d at 464, 18 U.C.C. Rep. Serv. (Callaghan) at 280. But is not the question whether the fees would likely be difficult to measure at the time of breach?
81. Id.
82. Id.
84. Id., 344 N.E.2d at 397, 381 N.Y.S.2d at 465, 18 U.C.C. Rep. Serv. (Callaghan) at 280.
of attorneys in the area of debtor-creditor relations is relevant. While plaintiff may enter into any fee arrangement it wishes with counsel, it should not be permitted to manipulate the actual damage incurred by burdening the defendant with an exorbitant fee arrangement.\(^{85}\)

The court remanded the case for a determination of whether the clause was reasonable in terms of the anticipated or actual harm and the normal charges of attorneys in the locale for collection work.\(^{86}\)

The court's analysis is correct only as far as it goes. The court failed to consider reasonableness in light of two other factors in section 2-718, the difficulty of proving loss and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. With respect to the "inconvenience" factor, since the buyer had agreed contractually to pay reasonable attorney's fees, an adequate remedy existed. With respect to the "difficulty" factor, the seller would have faced no difficulty in proving to the penny the exact amount of attorney's fees actually incurred. There is simply no reason to enforce a liquidated damage provision in situations in which the precise injury can be easily proved. Although this particular case probably would have come out the same regardless of whether the court enforced the liquidated sum (the actual and the liquidated damages being the same), the court's decision is dangerous precedent for future cases in which readily provable actual damages are much less than the sum liquidated. When such a case presents itself, perhaps the court will turn its decision on the other factors of reasonableness listed in the statute.

A much more provocative situation was presented to the Ninth Circuit in California & Hawaiian Sugar Co. v. Sun Ship, Inc.\(^{87}\) California & Hawaiian Sugar Company (C & H), an agricultural cooperative, had a pressing need for a vessel to transport raw sugar from its plantations in Hawaii to the mainland. It commissioned the building of a hybrid vessel, a tug of catamaran design to be connected to a barge, to produce a tug barge. Sun contracted to build the barge and Halter to build the tug. The contract with Sun specified a delivery date of June 30, 1981, and contained a clause liquidating damages for delay at $17,000 per day. Sun breached the contract by not completing the barge until March 16, 1982. Halter, however, did not complete the tug until July 15, 1982. C & H settled its claim against Halter, and the litigation involved only Sun.

Sun contended that the liquidated damage provision of $17,000 per day was an unenforceable penalty. Sun emphasized that the barge was useless to C & H without the tug and alleged that C & H would suffer no injury until Halter delivered the tug. Since Sun delivered the barge before Halter delivered the tug, C & H suffered no damages as a result of Sun's breach.

Although the court found Sun's argument "seductive," the court held the

\(^{85}\) Id.
\(^{86}\) Id., 344 N.E.2d at 397, 381 N.Y.S.2d at 465, 18 U.C.C. Rep. Serv. (Callaghan) at 280-81.
The court ruled that the clause was clearly reasonable in light of the anticipated loss. C & H had storage in Hawaii for only about one-quarter of its sugar crops. Without proper storage, sugar quickly goes to waste. C & H could avoid such loss only by having shipping available as promised by its contract with Sun.

In reaching its conclusion, the court found the disjunctive language of "anticipated or actual harm" in section 2-718 to be deliberate. The language was satisfied by the reasonably anticipated harm to C & H. The court also relied on the new Restatement of Contracts, which would validate a provision that "approximates the loss anticipated at the time of the making of the contract, even though it may not approximate the actual loss." The court recognized, however, that the Restatement apparently would uphold a provision that did not approximate actual damages only in cases in which the actual damage was uncertain or could not otherwise be easily proved.

Sun argued that it was clear from the record that C & H suffered no damages as a result of the breach because C & H could not have used the barge prior to the time Sun actually delivered it. Further, Sun contended that the parties intended the clause to operate only if the tug were available to integrate with the barge. Accordingly, Sun urged the court to follow the Restatement provision where "it is clear that no loss at all has occurred, a provision fixing a substantial sum as damages is unenforceable." The court rejected these arguments. It said:

The Restatement, however, deals with a case where the defaulting contractor was alone in his default. We deal with a case of concurrent defaults. If we were to be so literal-minded as to follow the Restatement here, we would have to conclude that because both parties were in default, C and H suffered no damage until one party performed. . . . The continued default of both parties would operate to take each of them off the hook. That cannot be the law.

The court thus found that C & H had suffered a substantial actual loss, although on the unique facts of the case all of that loss was not solely attributable to Sun. The court then emphasized the importance of enforcing liquidated damage clauses in cases in which actual damages are uncertain. The court said:

Where damages are real but difficult to prove, injustice will be done the injured party if the court substitutes the requirements of judicial

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88. Id. at 1439, 1 U.C.C. Rep. Serv. 2d (Callaghan) at 1219-20.
89. Id.
90. Id. at 1436, 1 U.C.C. Rep. Serv. 2d (Callaghan) at 1215.
91. RESTATEMENT (SECOND) OF CONTRACTS § 356 comment b (1979); see also supra notes 66-71 and accompanying text.
92. 794 F.2d at 1436-37, 1 U.C.C. Rep. Serv. 2d (Callaghan) at 1215-16; see RESTATEMENT (SECOND) OF CONTRACTS § 356 comment b, illustration 4 (1979); supra notes 60-73 and accompanying text.
94. 794 F.2d at 1437, 1 U.C.C. Rep. Serv. 2d (Callaghan) at 1216-17.
95. Id. at 1437-38, 1 U.C.C. Rep. Serv. 2d (Callaghan) at 1217.
proof for the parties' own informed agreement as to what is a reasonable measure of damages.

Proof of this loss is difficult—as difficult, perhaps, as proof of loss would have been if the sugar crop had been delivered late because shipping was missing. Whatever the loss, the parties had promised each other that $17,000 per day was a reasonable measure. The court must decline to substitute the requirements of judicial proof for the parties' own conclusion.6

The court was apparently of the opinion that $17,000 per day was not an unreasonable approximation of the loss actually suffered.

The decision in the C & H case represents an excellent analysis of the reasonableness test of section 2-718 and of the interplay between the various factors of reasonableness presented by the statute. One is left with some feeling that C & H may have received a windfall from enforcement of the liquidated damage provision, particularly since we are not told the amount received by C & H from its settlement with Halter.7 This, however, is the kind of uncertainty that should be resolved by a liquidated damage provision agreed to by arms' length negotiation. Presumably the case would have been decided differently had the evidence clearly showed that C & H had suffered no loss or one that was calculable at an amount much less than the liquidated sum.

D. Anticipated or Actual Harm

As discussed previously,8 the reasonableness factors listed in section 2-718(1) are interrelated; to discuss any one of them independently is, thus, somewhat misleading.9 Nevertheless, the "anticipated or actual harm" factor is probably the most important of those factors listed because the textbook example of a penalty is a payment of an amount wholly disproportionate to the harm that has been caused. At least this example is true when the amount liquidated greatly exceeds the injury. When the converse exists, the Code suggests that limiting, damages to the smaller liquidated sum might also be unconscionable.10 Further, in at least one kind of case the "harm" factor may become independent of the others and, in and of itself, invalidate a liquidated provision. If the provision approximates neither the anticipated nor the actual harm, courts should hold the clause per se unreasonable regardless of the difficulties of proving loss or of obtaining another remedy. Pre-Code cases reached this conclusion.11

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7. C & H received a judgment in excess of $4,000,000 under the liquidated damages clause. The contract prices of the barge ($25,405,000) and of the tug ($20,350,000) totaled almost $46,000,000.
8. See supra notes 48-59 and accompanying text.
10. See U.C.C. § 2-718 comment 1, which states: "A term fixing unreasonably large liquidated damages is expressly made void as a penalty. An unreasonably small amount would be subject to similar criticism and might be stricken under the section on unconscionable contracts or clauses." Id.
One can read the word "harm" itself as ambiguous. Does it include all injuries or only those injuries recoverable under the usual damage rules regarding foreseeability, certainty, and mitigation of damages? The better view is that the reference is to all harm, regardless of whether it would be compensable absent the liquidated damages clause. Without doubt, the fundamental purpose of agreed damages is to relieve the aggrieved party from the burden of proving uncertain damages. It also seems reasonable to allow the damages agreement to insulate the aggrieved party from meeting the amorphous standard of foreseeability and from countering allegations that the agreed damages could have been reasonably avoided.

With its "anticipated or actual harm" standard for reasonableness, the Code potentially represents a significant departure from the common law. Prior to the Code, however, jurisdictions were split on the role that actual damages should have in a determination of the validity of liquidated damage provisions. The majority of courts considered the extent of actual harm a factor they would consider in determining what losses might have been reasonably anticipated at the formation of the contract. A minority of courts, however, excluded all evidence regarding actual harm even for the purpose of determining what damages could reasonably have been anticipated. Section 2-718 does not expressly resolve this conflict. Although section 2-718 does refer to actual harm, the reference is in the disjunctive and, therefore, can be read to exclude evidence of actual harm if the clause is found to be reasonable in terms of the anticipated loss.

103. See also Nautilus Training Center No. 2, Inc. v. SeaFirst Leasing Corp., 647 S.W.2d 344, 347 (Tex. App.—Corpus Christi 1982, no writ) (when valid liquidated damages clause exists, court will enforce it and need not consider issue of mitigation); Robinson v. Granite Equip. Leasing Corp., 553 S.W.2d 633, 634 (Tex. Civ. App.—Houston [1st Dist.] 1977, writ ref’d n.r.e) (no duty to mitigate liquidated damages.)

104. United States v. Bethlehem Steel Co., 205 U.S. 105 (1907); Frick Co. v. Rubel Corp., 62 F.2d 765 (2d Cir. 1933); United States v. J.D. Streett & Co., 151 F. Supp. 469 (E.D. Mo. 1957), modified, 256 F.2d 557 (8th Cir. 1958); Norwalk Door Closer Co. v. Eagle Lock & Screw Co., 153 Conn. 681, 220 A.2d 263 (1966); see supra notes 12-13 and accompanying text.

105. See, e.g., Woodner v. Sankin, 188 F. Supp. 259, 260 (D.D.C. 1960) ("Liquidated damages in an amount that has no bearing and no relation to the actual damages suffered, and in an amount that is conceivably larger than any actual damages that are likely to be sustained, may be deemed to be a penalty and a penalty is not enforceable."); aff’d, 289 F.2d 873 (D.C. Cir. 1961).

106. See, e.g., Frick Co. v. Rubel Corp., 62 F.2d 765, 767 (2d Cir. 1933) (evidence as to actual loss irrelevant); Bryon Jackson Co. v. United States, 35 F. Supp. 665, 667 (S.D. Cal. 1940) ("Recovery of liquidated damages is allowed upon mere proof of an explicit contractual undertaking to that effect. No proof that in fact, damage did not flow from the breach is allowed."); see also United States v. Bethlehem Steel Co., 205 U.S. 105, 119 (1907) ("Courts . . . have now become strongly inclined to allow parties to make their own contracts, and to carry out their intentions over when it would result in the recovery of an amount stated as liquidated damages . . . without proof of the damages actually sustained.").
Commentators have suggested that the disjunctive phrasing, "anticipated or actual" harm, is subject to two interpretations. Under one interpretation, if the stipulated amount is disproportionate to either the actual or anticipated amount, courts should then invalidate the clause.1 This reading overlooks the disjunctive language of the phrase and would lead to absurd results in cases in which the clause reasonably approximates actual, although not anticipated, damages. Such a situation could arise, for example, when the clause was too broadly drafted so that it stipulated a single sum to cover a multitude of breaches that would potentially cause varying degrees of injury. The courts would invalidate the clause even though it approximated the injury actually caused. Professor Hawkland well states the impracticality of such an interpretation:

[I]t should not matter that the predicted loss did not accord with the common viewpoint of prudent businessmen at the time the agreement was made, because subsequent events have proved it right. . . . Indeed, there would be no sense in striking down such a clause, because that would leave the court in a position requiring it to determine damages under usual legal tests, which would bring it to the same dollar amount as the liquidated clause.109

A second suggested interpretation would allow a court to uphold a clause if either the actual or anticipated harm corresponds with the amount stipulated.110 This reading follows literally the disjunctive language of section 2-718(1). This interpretation, however, should not be taken out of context with the other factors of reasonableness in section 2-718(1). Otherwise, unfair results will obtain in cases in which the liquidated damage clause greatly exceeds the injury actually suffered. Such cases have always been the hard liquidated damages cases. Although the stipulated sum may approximate the anticipated loss, it makes no sense to enforce the clause if actual damages are readily provable at a different amount. To enforce the clause in such cases is to impose a penalty.

Thus, a third and better interpretation would hold the clause suspect in cases in which it apparently does not reasonably approximate the actual harm. In such cases, the court should turn to the other factors in section 2-718 to determine the reasonableness of the clause. Most important in this

107. See 5 Corbin, supra note 9, § 1063, at 367; D. Dobbs, supra note 102, § 12.5, at 823.
regard would be the difficulty of proving loss. If damages can be readily proved, then a court should not enforce the clause merely because it approximates a loss that did not occur. A court should never knowingly allow a liquidated damages clause to operate as a penalty. It is simply no response to say that the parties have agreed to the amount liquidated. In liquidating damages the parties assumed that the loss caused by the breach would be uncertain in amount and difficult to prove. They intended the clause only as approximation of that loss and not as an allocation of risk. As it turns out, the parties were mistaken in their assumption. Principles of freedom of contract should not operate to enforce penal damages when such was not the intent of either party. If the parties had actually intended to allocate the risk of penal damages, the court would certainly invalidate the agreement under any interpretation of section 2-718 or of the common law.

There is thus no reason to allow a clause liquidating damages to operate as a penalty subsequent to the breach if actual damages can be readily proved. Courts should always restrict liquidated damage provisions to situations in which the anticipation of the parties at the time of contracting turns out to be true; that is, to situations in which the actual damages caused are uncertain or otherwise are difficult to prove. For this reason, the "difficulties of proof of loss" factor of reasonableness in section 2-718(1) often will be of equal importance to that of "anticipated or actual harm."

E. Difficulties of Proof of Loss

The classic reason for enforcing liquidated damage provisions is that damages are uncertain or otherwise difficult to prove. Only when damages are uncertain should courts allow the parties by agreement to usurp the judicial function of measuring damages in a given case. Section 2-718 carries this theme forward by listing as a key factor of reasonableness "the difficulties of proof of loss."

The key question presented by the "difficulty" factor is the time at which the difficulty is to be determined, that of contracting, or of breach, or of trial. Unfortunately, the majority of courts has historically viewed the situation at the time of contracting. This common law rule was based on a misread-

111. Professor Honnold rejected an interpretation that would invalidate a clause that is disproportionate to actual damages if it approximated anticipated damages. 1 NEW YORK LAW REVISION REPORT ON THE UNIFORM COMMERCIAL CODE 581 (1955); see W. HAWKLAND, supra note 55, § 2-718:02, at 427 (1982). The professor's position is certainly correct for situations in which the actual loss is difficult to prove.

112. See RESTATEMENT (SECOND) OF CONTRACTS § 356 comment b (1979):

A determination whether the amount fixed is a penalty turns on a combination of . . . two factors. If the difficulty of proof of loss is great, considerable latitude is allowed in the approximation of anticipated or actual harm. If, on the other hand, the difficulty of proof of loss is slight, less latitude is allowed in that approximation. If, to take an extreme case, it is clear that no loss at all has occurred, a provision fixing a substantial sum as damages is unenforceable.

113. See RESTATEMENT OF CONTRACTS § 339(1)(b) (1932).
115. See 5 CORBIN, supra note 9, § 1060, at 350; supra notes 15-29 and accompanying text.
ing of the original Restatement of Contracts, which courts often cited to support the rule. The Restatement stated that agreements fixing damages were not enforceable unless "the harm that is caused by the breach is one that is incapable or very difficult of accurate estimation."116 This language looks obviously to the actual injury, rather than that anticipated. The comment to the provision makes the conclusion all the more clear:

If the parties honestly but mistakenly suppose that a breach will cause harm that will be incapable or very difficult of accurate estimation, when in fact the breach causes no harm at all or none that is incapable of accurate estimation without difficulty, their advance agreement fixing the amount to be paid as damages for the breach is within the rule stated in Subsection (1) and is not enforceable.117

The new Restatement takes something of a middle ground, depending upon the degree of difficulty. It provides:

If the difficulty of proof of loss is great, considerable latitude is allowed in the approximation of anticipated or actual harm. If, on the other hand, the difficulty of proof of loss is slight, less latitude is allowed in that approximation. If, to take an extreme case, it is clear that no loss at all has occurred, a provision fixing a substantial sum as damages is unenforceable.118

To date no court has directly addressed the question of when one measures "the difficulties of proof of loss" under section 2-718. Commentators have divided on the question.119

The new Restatement, which represents an attempt to parallel section 2-718,120 provides the best resolution of the matter. Courts should never enforce a liquidated damage provision when actual damages are easily proved. The difficulty of proving loss and the accuracy of the estimate of the parties, however, will usually be a matter of degree.121 The Code provides both sell-

117. Id. § 339 comment c.
118. Id. § 356 comment b. Compare id. illustrations 3, 4 with § 356. Illustration 3 provides:

A contracts to build a grandstand for B's race track for $1,000,000 by a specified date and to pay $1,000 a day for every day's delay in completing it. A delays completion for ten days. If $1,000 is not unreasonable in the light of the anticipated loss and the actual loss to B is difficult to prove, A's promise is not a term providing for a penalty and its enforcement is not precluded on grounds of public policy.

Id. § 356 comment b, illustration 3. Illustration 4 provides:

The facts being otherwise as stated in Illustration 3, B is delayed for a month in obtaining permission to operate his race track so that it is certain that A's delay of ten days caused him no loss at all. Since the actual loss to B is not difficult to prove, A's promise is a term providing for a penalty and is unenforceable on grounds of public policy.

Id. § 356 comment b, illustration 4.

119. See Comment, Liquidated Damages: A Comparison of the Common Law and the Uniform Commercial Code, 45 FORDHAM L. REV. 1349, 1359 (1976) (time of breach); Sweet, supra note 3, at 109 (time of contracting); see also W. HAWKLAND, supra note 55, § 2-718:03, at 429-30 (time should be time of contracting).

121. See D. DOBBS, supra note 102, § 12.5, at 822 (any degree of difficulty should be enough to uphold liquidated damages clause).
ers and buyers a panorama of accessible damage remedies and a rule of law that relaxes the certainty requirement for proving loss.\textsuperscript{122} The net result is that actual damages will usually be reasonably susceptible of proof, and courts will rarely enforce liquidated damage provisions in sale of goods cases.\textsuperscript{123} That is as it should be.

If proving damages presents no apparent difficulty and the liquidated damage clause is out of line with the damages actually suffered, no reason exists for enforcing the clause. Conversely, if actual damages can be readily proved, but the clause is apparently a reasonable approximation of the loss, courts should not require proof of damages and should enforce the clause. Once the party seeking to enforce the liquidated damage clause has made a basic showing that the provision was part of the agreement, the burden of going forward with proof of unreasonableness should fall on the other party. Unfortunately, this allocation presents one party with the ostensibly difficult task of proving the other party’s damages. The task, however, is not to prove the actual loss with precision. The burden should only be to raise credible evidence that the pre-estimate is well out of line with the actual loss. In most cases in which this situation arises, that burden should not be difficult. Those jurisdictions that historically have looked to the time of breach to ascertain difficulty have demonstrated little trouble with having the party who defends against an agreement liquidating damages prove unreasonableness.\textsuperscript{124} In cases of doubt either as to the accuracy of the amount stipulated or as to the difficulty of proving actual loss, courts should enforce the agreed clause.

The old rule that ignored the ease of proof of actual damages when judging the validity of a liquidated damage provision was based on a freedom of contract philosophy,\textsuperscript{125} the idea that courts should enforce an agreement according to its terms. This philosophy is misfocused. Properly construed, a liquidated damage provision does not represent an agreement to allocate risks, because it is not an agreement that one party will pay a penalty. Both pre-Code law and the Code itself would void such an agreement.\textsuperscript{126} An agreement that provides for penal damages is an unconscionable attempt to modify remedies and should also fail under section 2-719 on agreed remedies. When parties validly stipulate as to damages, they are required to make a reasonable approximation and to base that approximation on an assumption that the damages will be uncertain and difficult to prove. If in

\textsuperscript{122} U.C.C. \textsection 1-106 (1978).
\textsuperscript{123} See supra notes 35-47 and accompanying text; see also Comment, supra note 119, at 1359 (since market value of goods at time of breach is ascertainable, valid liquidated damage provision under Code is rare).
\textsuperscript{124} See Johnson Engineers, Inc. v. Tri-Water Supply Corp., 582 S.W.2d 555, 557 (Tex. Civ. App.—Texarkana 1979, no writ) (burden of proof was that stipulated amount did not fall within "permissible range" of actual damages).
\textsuperscript{126} See U.C.C. \textsection 1-106 (1978), which states that "neither consequential or special nor penal damages may be had except as specifically provided in this Act or by other rule of law." Id.
actuality no such difficulty arises upon breach and the parties' assumption has proved to be mistaken, courts should enforce the agreed damages no more than any other contract provision that is found to be premised upon mutual mistake.

The best Code case to date demonstrating the impact of the "difficulty of proof of loss" factor is Equitable Lumber Corp. v. IPA Land Development Corp.,127 discussed above.128 In Equitable Lumber the court found that the liquidated damage provision was clearly a reasonable approximation of damages that the breach would likely cause. The seller argued that, since the buyer had no use for the barge prior to the time the seller delivered it, the buyer suffered no actual loss. The court did not dismiss this argument as irrelevant, which it would have done had it regarded section 2-718 as being concerned entirely with reasonableness at the time of contracting. Instead, the court looked to the actual injury suffered and then rejected the seller's argument on the unique facts of the case.129

F. Inconvenience or Nonfeasibility of Otherwise Obtaining an Adequate Remedy

The final factor listed in section 2-718(1) for judging reasonableness is "the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy."130 This factor is new, having had no pre-Code counterpart. No court to date has directed its attention to it. Its meaning is not clear, but it probably represents nothing more than a particular example of "the difficulties of proof of loss." If a plaintiff cannot prove his loss, he has little chance of obtaining an adequate remedy. The new Restatement, which attempts to parallel Section 2-718(1), does not include the "inconvenience" factor in its provision because it finds the factor to be merely duplicative.131

One importance of the "inconvenience" language in section 2-718 is that it emphasizes that courts should rarely enforce liquidated damage provisions in sale of goods transactions. Whether one tests the efficacy of the clause at the time of contracting or at the time of breach, it is not likely that the parties would reasonably anticipate no adequate remedy for breach or that, in fact, no adequate remedy exists after breach. Most goods sold in commerce have regularized markets against which parties can calculate the damages.132

As with judging the difficulties of proving loss, courts should judge the inconvenience or nonfeasibility of obtaining a remedy based on the circum-

129. Id.
132. See supra notes 37-40 and accompanying text; see also Comment supra note 119, at 1363 (discusses inconvenience or nonfeasibility of otherwise obtaining adequate remedy).
stances existing at the time of trial. Only at that time can courts determine the availability of an adequate remedy. What difference should it make that the parties may have, quite reasonably, thought at the time of the contracting that a remedy might not be available? The only criticism of this view is that it substantially restricts the enforceability of liquidated damage provisions in sale of goods transactions. The criticism is misplaced. In sales transactions of goods having established markets, rare will be the case in which the parties at the time of contracting can reasonably anticipate the lack of an available remedy. The Code provides a broad spectrum of reasonable remedies for sellers and buyers underscored by a fundamental principle of compensation. Courts should not sacrifice those remedies and that principle to an erroneous assumption of the parties at the time of contracting.

G. Liquidated Damages as an Exclusive Remedy

Once a liquidated damage clause has been shown to be part of the agreement, it represents the exclusive remedy available to the aggrieved party, who may not seek other damages or other legal remedies. This was the well-settled rule at common law and is almost certainly the rule under section 2-718.

Section 2-718 contains no requirement that the parties expressly agree that the remedy is exclusive. A liquidated damage clause, nevertheless, is an agreed remedy, and section 2-719 provides that "resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive." To date, however, the courts have not read section 2-719 as placing a limitation on liquidated damage provisions. In the words of one court, "a liquidated damage clause, without evidence to the contrary, is so inconsistent with any other damage remedy as to require a conclusion that it contemplates exclusiveness." Another court expressed its opinion as follows: "We find it difficult to visualize a clearer way to express an exclusive limita-

134. W. HAWKLAND, supra note 55, § 2-718:04, at 430; Comment, supra note 119, at 1363.
137. 5 CORBIN, supra note 9, § 1061, at 353; Comment, supra note 119, at 1367-80.
139. The best judicial analysis of this issue is in Ray Farmers Union Elevator Co. v. Weyrauch, 238 N.W.2d 47, 49, 18 U.C.C. Rep. Serv. (Callaghan) 683, 686 (N.D. 1975) ("Any other conclusion would negate the purpose of [section 2-718(1)]."). The court, however, restricted its analysis to damage remedies, reserving judgment as to whether § 2-719 would require an expression of exclusivity to bar nondamage remedies such as specific performance, injunction, rescission, etc. Id.; see Council Bros, Inc. v. Ray Burner Co., 473 F.2d 400, 11 U.C.C. Rep. Serv. (Callaghan) 1126 (5th Cir. 1973).
tion on the measure of damages than by liquidating them. The Code cases to date are in uniform accord.

A different situation arises with respect to equitable remedies. The general rule at common law was that a liquidated damage provision did not bar recourse to equitable remedies. A court in equity should not allow its jurisdiction to be determined exclusively by private agreement, although such an agreement is a factor to be considered. The few Code cases to date indicate that the common law view will continue to prevail. If the equitable remedy sought is one merely for lost expectation, such as specific performance, rather than one designed to punish wrongdoing, such as constructive trust or equitable lien, the court will probably honor an express agreement that the liquidated damage provision is the exclusive remedy. Thus, one case held that a liquidated damage provision containing express language that it was the exclusive remedy could preclude specific performance.

The court would honor the agreement because the agreement should be interpreted as merely allowing the breaching party the privilege of paying the agreed sum, rather than performing the agreement.

**H. Unreasonably Large Liquidated Damages**

After listing the factors courts should consider in determining the reasonableness of a liquidated damage provision, section 2-718(1) provides: "A term fixing unreasonably large liquidated damages is void as a penalty." This language merely states the consequence if a court should find the provision unreasonably large in light of the factors of reasonableness listed in section 2-718(1).

The one case that has directly addressed this provision reached the curious conclusion that it establishes an independent criterion that must be met before a court may validate the liquidated damage clause. The court said: "Having satisfied the test set forth in the first part of § 2-718(1), a liquidated damages provision may nonetheless be invalidated under the last sentence of

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143. Comment, supra note 119, at 1367-80.


146. Id. at 72-73.


148. Id.

the section if it is so unreasonably large that it serves as a penalty rather than a good faith attempt to pre-estimate damages..."150 The court did not explain how it could hold a clause “unreasonably large” once it had found the same clause reasonable in terms of the factors listed in the first sentence of section 2-718(1). Had the court not limited its inquiry to the anticipated harm caused by the breach, the court’s conclusion would be more understandable. Courts can sensibly read the second sentence of section 2-718 as an independent test of reasonableness only if its reference is to the damages that actually occurred. Thus, although the court may find a clause reasonable in terms of the factors listed in the first sentence to section 2-718, the court may nevertheless invalidate the clause if it finds the clause unreasonably large in light of the damages that actually occur. For the reasons emphasized throughout this Article, an interpretation that focuses on the actual harm is preferable.151

I. Unreasonably Small Liquidated Damages

Although the Code provides that unreasonably large liquidated damages are void as a penalty, the text to section 2-718(1) states no consequence for a clause providing for unreasonably small liquidated damages. The Official Comment to the provision fills the void: “A term fixing unreasonably large liquidated damages is expressly made void as a penalty. An unreasonably small amount would be subject to similar criticism and might be stricken under the section on unconscionable contracts or clauses.”152 Thus, a party limited to unreasonably small damages is penalized as much as one required to pay unreasonably large damages, a result that may be unconscionable. Professor Hawkland puts the matter well:

There is a vast difference in the pernicious effects of unreasonably large and unreasonably small liquidated damages. Unreasonably large liquidated damages have an in terrorem effect that strongly deters a party from breaching his contract. Unreasonably small liquidated damages, on the other hand, tend to induce a party to breach a contract if the alternative of performing it becomes even slightly disagreeable. The first kind involves a penalty; the second involves an unconscionable limitation on remedies, depriving the aggrieved party of a fair quantum of recovery.153

A clause providing for unreasonably small liquidated damages is, in effect, a limitation on remedies and courts should judge the clause under the standards of section 2-719, rather than under those of section 2-718. If one of the parties alleges that the clause is unconscionable, the court should make a distinction as to whether the unconscionability arises from the time of contracting or from the way the clause is operating in light of the damages that have occurred. Section 2-302 governs unconscionability at the time of con-

151. See supra notes 48-135 and accompanying text.
trating and requires a separate hearing on unconscionability by the trial court.\textsuperscript{154} If the clause is acting in an unconscionable manner, a case is made for "intervening" unconscionability under section 2-719, which requires no separate hearing on the issue of unconscionability. The party would argue that the clause has "fail[ed] of its essential purpose" under section 2-719(2).\textsuperscript{155} A separate hearing by the trial court would not then be required.\textsuperscript{156}

The important point is that a mere showing that actual damages exceed the amount liquidated does not automatically validate the reasonableness of the liquidated damage provision. Of course, if the aggrieved party makes such a case and is nevertheless satisfied with the amount liquidated, courts should enforce the clause.\textsuperscript{157} The intent of the parties must provide the primary focus for courts in determining whether a provision is unreasonably small. If the intent was to liquidate damages, courts should invalidate the clause as unreasonable under section 2-718. If, on the other hand, regardless of the language used by the parties, the intent was to limit remedies, courts should judge the clause under the standards of section 2-719 on limitation or modification of remedies. This alternative was the approach taken by one court in a case involving the sale of an experimental aircraft.\textsuperscript{158} The contract provided that the seller would incur no liability for failure of or delay in delivery, but that in such an event the buyer "may cancel this order and have the full deposit refunded."\textsuperscript{159} The court determined that the clause was an attempt to limit remedies rather than to liquidate damages to the amount of the deposit.\textsuperscript{160} The court then concluded that the clause both met the requirements of section 2-719 and was not unconscionable under section 2-302.\textsuperscript{161} The buyer was thus restricted to the refund remedy. Conversely, a court found in another case that a similar provision was an attempt to liquidate damages.\textsuperscript{162} Accordingly, the seller could pursue his other remedies under the Code if he could prove that the amount liquidated was unreasonably small.\textsuperscript{163}

Contracts for burglar alarm service represent recurring examples of situations in which contracts provide for small "liquidated" damages. The con-

\textsuperscript{154} See U.C.C. § 2-302 (1978); see also, Comment, supra note 119, at 1366-67 (1977) for a discussion of the rights afforded a party for a hearing on the issue of unconscionability.

\textsuperscript{155} U.C.C. § 2-719(2) (1978).

\textsuperscript{156} See Dow Corning Corp. v. Capitol Aviation, Inc., 411 F.2d 622, 627, 6 U.C.C. Rep. Serv. (Callaghan) 589 (7th Cir. 1969) (assessing unconscionability of liquidated damage provision without separate hearing).


\textsuperscript{158} Dow Corning Corp. v. Capitol Aviation, Inc., 411 F.2d 622, 6 U.C.C. Rep. Serv. (Callaghan) 589 (7th Cir. 1969).

\textsuperscript{159} Id. at 626, 6 U.C.C. Rep. Serv. (Callaghan) at 594.

\textsuperscript{160} Id.

\textsuperscript{161} Id. at 626-27, 6 U.C.C. Rep. Serv. (Callaghan) at 595.


\textsuperscript{163} 370 So. 2d at 63, 26 U.C.C. Rep. Serv. (Callaghan) at 718.
tract usually states that the burglar alarm service company will incur liability in the event of breach for damages “liquidated” in some small amount, say $50. Quite obviously, one does not hire such a service to protect property worth no more than such a small amount. The clause is thus not a reasonable forecast of either the anticipated or, as the cases develop, the actual harm. Nevertheless, courts have uniformly upheld the clauses on the reasoning that, regardless of the language used, the intent was to limit and not to liquidate damages. Absent a showing of unconscionability, courts uniformly enforce such clauses. Although these cases do involve service contracts and are thus not governed by the Code, the analysis by the courts is instructive with respect to determining the validity of clauses that provide for small liquidated damages.

III. Litigation and Drafting Aspects

A. Litigation

The party seeking to enforce a liquidated damage provision has the burden of proving its validity. Under the Code, this burden requires the aggrieved party to prove not only the reasonableness of the provision, but also its own compliance with the terms of the contract so that it is entitled to performance from the breaching party. The aggrieved party must also prove that the clause is part of the agreement and that the clause is applicable according to its terms.

An agreement liquidating damages can be shown by custom or usage of trade. In sales of livestock courts have held that, in the absence of a showing in the livestock trade of treating a down payment as liquidated damages or of any other evidence of such an intent by the parties, the mere fact of a down payment does not warrant a holding that the payment represents liquidated damages.

In attacking a liquidated damage clause, the aggrieved party should take the position that the clause is unreasonable in terms of the specific factors listed in section 2-718(1). As this Article has demonstrated, however, important questions remain open under section 2-718 as to the point in time

that is relevant to a determination of reasonableness in light of the specified factors. Accordingly, the aggrieved party should present evidence at trial as to the facts as they existed both at the time of contracting and at the time of breach or trial.

The legal effect of a court's finding that a liquidated damage provision is invalid is clear. The court merely expunges the clause from the contract; the validity of the remainder of the contract is not impaired. The promisee may then recover actual damages under the Code as if the clause had never been a part of the contract.171

A valid liquidated damage provision functions to do just that, liquidate damages. The law almost everywhere provides that parties may recover pre-judgment interest for nonpayment of a liquidated debt from the date of breach until judgment. In the words of Professor Corbin: "If damages that would have been too uncertain in amount have been liquidated at a certain amount by agreement, interest is recoverable from the date when that amount was payable."172 Parties must remember that many jurisdictions require the aggrieved party to specially plead a claim for pre-judgment interest.

B. Drafting

The courts have often held that the language used by the parties in a liquidated damage provision is unimportant and will not determine the provision's validity.173 As a corollary to the general principle that the intent of the parties to stipulate damages will not prevent the striking of the clause as a penalty, the courts have commonly found invalid clauses that specifically stated that damages were "liquidated."174 Conversely, the courts have held provisions for liquidated damages to be valid despite the use of words such as "forfeit" or "penalty."175 Nevertheless, it is probably unwise as a drafting proposition to so taint the clause. In a close case, such language might make all the difference.

The courts have upheld liquidated damages provisions both when a specific sum176 was provided and when a formula was provided to determine the amount stipulated.177 A formula should be used when the parties antici-

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171. See Dunbar, supra note 1, at 227.
172. 5 CORBIN, supra note 9, § 1046.
173. Id. § 1058.
174. See supra notes 48-73 and accompanying text; see also Zurich Ins. Co. v. Kings Indus., Inc., 255 Cal. App 2d 919, 63 Cal. Rptr. 585, 588 (1967) (upholding as remedy limitation provision that provided that damages were "liquidated").
175. See Uncle George Orphans Home, Inc. v. Landrum, 551 S.W.2d 582, 584 (Ky. Ct. App. 1977).
pate that the breach might cause varying degrees of injury. If the formula can be tied to the seriousness of the breach, parties can avoid a major pitfall in drafting liquidated damage provisions. The courts historically have stricken liquidated damage provisions as penalties in cases in which the clause was so broadly drafted that a single specified sum applied to numerous types of breaches of potentially varying degrees of importance. The consistent reasoning of the courts has been that such a provision could not be a reasonable approximation of damages likely to be caused by the breach.

The lesson is that parties should always draft a liquidated damages clause quite narrowly so that the agreed sum relates to a particular, specified breach or so that the applicable formula takes into account the potential for variance in the harm caused by the breach.

Parties should never draft a liquidated damage clause so as to allow the aggrieved party “to eat his cake and have it too.” The courts have found unreasonable clauses that provide for a minimum of stipulated damages with the option for the aggrieved party to recover additional damages that might be proved. The reasoning is that such clauses cannot represent a reasonable attempt to estimate damages.


178. See 5 CORBIN, supra note 9, § 1066, for a collection of these cases.

179. See Jarro Bldg. Indus. Corp. v. Schwartz, 54 Misc. 2d 13, 281 N.Y.S.2d 420, 426 (1967); see also J. CALAMARI & J. PERILLO, supra note 102, § 14-32, at 645 (discusses “the eat cake and have it” clause). But see In re Plywood Co., 425 F.2d 151, 156 (3d Cir. 1970) (liquidated damage provision enforced, but option for additional damages disallowed).