EXPECTANCY AND LIQUIDATED DAMAGE CLAUSES: SPECULATIONS ON THE CONFLICT OF ENFORCEMENT

by S. ANDREW OSTAPSKI* and DONALD A WIESNER"

ENFORCING THE PROMISE OR NOT

Classical contract theory[1], focusing on freedom to contract, imposes on the contracting parties the basic duty of complying with the terms of their bargained for agreement. Society oversees this process and somehow is expected to assure its fulfillment or to respond, when there is frustration, through such reactions as loss of reputation, moral disdain[2] or legal sanction.[3]

Preaching this traditional view may appear to be somewhat trite to the breaching party who, in failing to see the benefit, seeks release from the

'Assistant Professor of Business Law, University of Miami at Coral Gables, Florida "Professor of Business Law, University of Miami at Coral Gables, Florida 'Professor Gilmore claims that it was Oliver W. Holmes who created the broad philosophical foundation for the classical theory. Holmes formulated the bargain theory of consideration and affirmed that contract breathers had a right to break their contracts by paying damages. Gilmore states that contract law cannot adequately deal with the principle of liability when there is failed performance. G. Gilmore, The Death of Contract 14, 93 (1974). *See* O.W. Holmes, The Common Law 230 (1963).

[2]In his philosophical analysis, David Hume speculated that the external sanction of public disgrace, of lot* of reputation for honesty, which society attaches to promise-breaking, becomes internalized and instinctual in members of society, and accounts for the sense of moral obligation behind the promise, which, in contract formation, supports the bargained for agreement. D. Hume, A Treatise of Human Nature 516-525 (Oxford, 1988).

'Professor Milhollin disputes Gilmore's thesis that contract is dead. General contract law provides a flexibility for private initiative and "no sanction...can ever supply the benefits of performance.' Milhollin, *More on the Death of Contract,* 24 CATH. U. L. REV. 29,60. But how can one assure performance?

bargain.[4] Enforcement of contractual obligations rests on the questionable proposition that the parties are morally free to bargain as they please, within certain obscure parameters, the full recognition of which are rarely appreciated. Are parties allowed to freely commit themselves to questionable commitments? Does the legal system have a sensible protocol for policing this freedom? Are some commitments more sensitive to judicial scrutiny than others? The preceding question fuels the present inquiry. Parties, who break their "contractual" promises, disappoint and frustrate promisees but the degree to which and the manner in which the legal system responds to those encountering hindered expectations remains an unhappy medley of solutions that can only be explained by history[3] and some guesswork.

VALUE REMAINS VALUABLE

Consideration,[6] the presumed raison d'etre for bargaining, is the contract optimist's motivation for performance. Alternatively, the liquidated damage clause,[7] acting as the agreed upon substitute for performance, allows the pessimist to cope with the anticipated disappointment when fulfillment of contractual obligations appear improbable. In particular, liquidated damage commitments in contracts provide an expansive arena for examing the specific terms underlying the process of contract formation. The apparent attempt of one or both of the parties to obtain a qualitatively equal value, whether the contract is or is not performed, tests the validity of classical contract theory.

The objectives of this paper include uncovering any hidden trends supportive of the liquidated damage doctrine and a brief analysis of the policy which courts advance in monitoring compliance with contractual obligations. This article primarily speculates on the nature of judicial policy pertaining to contractual disappointments, occasioned by breach, by using the liquidated damage clause as the examining vehicle.

If contracting parties freely provide for the consequences of a breach, to what extent does the legal system respond? But, if freedom to contract is to

'Obtaining release is not such an easy task. Grounds such as failure of consideration, fraud or repudiation must be established for a party to be freed from contractual obligations. Furthermore, a party who seeks relief by way of rescission must not be in substantial default of the agreement. Maytag Co. v. Ahvard, 253 Iowa 455, 112 N.W.2d 654, 660 (1962).

[5]*See* Arnold, *Toward an Ideology of the Early English Law of Obligations,* 5 LAW AND HIST. REV. 505-521 (1987).

'Business law authorities generally agree as to the basic definition of consideration. The authors of one reference work describe consideration as 'a legal benefit or advantage to the promisor or a legal detriment or disadvantage to the promisee as a result of the promise. It is a requirement of every contract, and it must be legal and of some value.* D. WIESNER *A* N. GLASKOWSKY, BUSINESS LAW 47 (1985).

''*See* note 18 *infra.*

mean anything, on a more basic level, should there even be a response if one fears paternalism?[8] In certain instances, courts solemnly pronounce, citing precedent for support, that if the damage clause is "penal" in nature then it must fail because society chooses to override the freely expressed wishes of the contracting parties.[9] Do such stipulated clauses really provide for a "cruel and unusual punishment"[10] from which the parties need to be protected?[11]

IGNORING CONSIDERATION BUT DAMAGE CLAUSES ARE TESTED

Somehow liquidated damage clauses were subject to a scrutiny that the consideration doctrine escaped. Historically, the formal contract was supported by a surety to assure performance. With the elimination of the surety, the obliging party to the contract made a direct obligation by entering into a legally binding promise that was supported by consideration.[12]

By the fifteenth and early sixteenth century, the word "consideration" was used to express the acts or other circumstances that were the motive or reason for a given transaction. In 1587, in the case of *Sturtyn* v. *Albany,* it was said that "when a thing is to be done by the plaintiff, be it ever so small, this is a sufficient consideration to ground an action."[13]

Four centuries of judicial rulings have supported the proposition that consideration need not be adequate to enter into a legally enforceable

*The Supreme Court of Ohio enforced the stipulated damages clause in a condominium agreement and declined to 'stand the law of contracts on its proverbial head." Nottingdale Homeowners' Ass'n v. Darby, 514 N.E.2d 702,705 (Ohio 1987) hereinafter cited ai Nottingdale. The court upheld freedom of contract principles by declaring "A rule of law which prevents parties from agreeing to pay the other's attorney fees, absent a statute or prior declaration of this court to the contrary, is outmoded, unjustified and paternalistic." Nottingdale at 707.

'One commentator states that the issue of disproportionate compensation is the true basis of society's reaction against penalty clauses and not necessarily a societal aversion to punishment. "Penalty clauses, which increase the measure of damages in the event of breach of contract, necessarily violate the anti-distributive policy of the courts....The purpose of these controls therefore goes beyond paternalistic motives, and represents an insistence by the courts that the distributive pattern established by the compensatory principle should not be upset." H. Collins, The Law of Contract 192 (1986).

[10]In the context of criminal law, the ultimate test remains whether the punishment prescribed shocks the conscience and offends fundamental notions of human dignity. Smith v. Municipal Court of Cty. of San Joaquin, 144 Cal. Rptr. 504 (1978).

"Remedies for breach of contract are generally compensatory in nature. Punitive damages are not available for mere breach of contract, because only a private wrong, and not a public right, is involved. M. S. R. Associates, Ltd. v. Consolidated Mut. Ins. Co., 58 App. Div. 2d 858, 396 N.Y.S.2d 684, 685 (1977).

[12]Committee of the Association of American Law Schools, Selected Readings on the Law of Contracts 4 (1931).

[13]Cro. Eliza. 67; cp. Bunniworth v. Gibbs (1654), Style 419 per Rolle, CJ.

agreement.[14] Presumably, society deemed parties of relatively equal bargaining position and free from legal disability to be quite capable of establishing the appropriate amount of consideration sufficient to support a contract. After all, the value of the consideration is truly in the eye of the beholder.

Even though adequacy of consideration was not a legal issue, ironically, liquidated damage clauses could not escape the protective scrutiny of society.[13] The irony exists because the liquidated damage clause, in function, fulfilled the role of surety when performance by the debtor would not be forthcoming. And yet, no credible reason surfaces why one substitute for performance is more legitimate than another.

The evolvement of debt, instead of simplifying the mechanics of contract performance, brought a certain inadequacy of remedy because it failed to satisfy the contract pessimist's need for substituted performance.[16] Perhaps there existed societal suspicion that the stipulated substitute for performance would be more onerous than the originally agreed upon term.

THE TERROR OF "IN TERROREM"

Controlling another person's behavior and forcing the performance of onerous terms has been an object of thought since early times. So even then, people practiced elaborate means to disinherit those worthless relatives whose recalcitrant attitudes or acts were viewed as intolerable. By use of discreet, clever clauses in testamentary dispositions, testators extended their attempts to govern others from the active guile of life to the pit of the grave. Inheritances would be conditioned upon prohibition of marriage or even, as unlikely, a demand upon a particular marriage.[17] Early courts viewed these harsh restrictions akin to punishment, which, by its very nature, would strike

"Piccadilly Square v. Intercontinental Const. Co., Inc., 782 S.W. 2d 178 (Tenn. App. 1989). In fact, it is improper for courts to inquire into adequacy of consideration. Harrison-Floyd Farm Bur. Co-op v. Reed, 546 N.E2d 855, 857 (Ind. App. 1989).

''Liquidated damage clauses have been traditionally disfavored. 'Since natural equity is best satisfied by the payment of actual damages and no more, interpretation leans against holding a sum in a contract to be liquidated damages...' *J.* Bishop, Commentaries on the Law of Contracts 622 (Second Edition 1907). Relief is afforded even when the transaction is fully voluntary and the parties have equal bargaining power. *See* Goetz *&* Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach,* 77 COLUM. L. REV. 554, 588-93 (1977).

"In the fourteenth century, "the very point of the bond was that it was penal, for that was the best mode of insuring performance. And performance was what was valued." Arnold, *supra* note 5, at 512.

'^Enforcement of these provisions actually reflected the attitudes and mores of the particular times in which these matters were brought to court. This conclusion can be drawn from comments such as "The law...recognizes as valid conditions in restraint of marriage which are just, fair, and reasonable." Phillips v. Ferguson, 85 Va. 509, 8 S.E. 241, 243 (1888).

grave concern or even inflict terror upon the conditioned beneGciary. Appropriately, these clauses were known as "in terrorem" clauses, from which scourge the courts released the oppressed. The ameliorative hand of judicial policy tempered the mean spirit underlying the "in terrorem" clause and the formalistic aspect of contract enforcement became more dependent upon judicial policy than the volition of the parties. This reaction against penalty provisions[18] later resurfaced when liquidated damages clauses were struck down as being unduly harsh.[19] The unenforceability of an "in terrorem" clause creates a vacuum which allows the contract breacher an easy escape.[20]

APPROACHES TO CONTRACTUAL NON-PERFORMANCE

Possible options to non-performance of a contract could be acquiescence, penalty, compensatory damages, or alternative performance. Constructing an accurate definition of each possibility is far from a simple task but necessary to understand a party's reaction to contractual disappointments.

Acquiescence may be a suitable reaction to breach of contract especially when no advantage is to be gained in pursuing the assetless breacher other than having the satisfaction of pressing a legitimate claim which further burdens the already overburdened breacher.

"Judges viewed the matter fairly simply. As one court noted, 'Liquidated damage is a sum agreed upon by the parties, at the time the contract is entered, payable as compensation for injuries in the event of default. A penalty, in contrast, is inserted in a contract as punishment for default rather than as a means for compensation. In re Holiday Mart, Inc., 9 B.R. 99, 107 (Bankr. D. Haw. 1981). Unfortunately, a penalty to one party could be perceived as a valid liquidated clause to another. The line blurs and confusion results.

''In the bankruptcy context, where liquidation can create ruin, the court appears to avoid excessive harshness to the debtor-breacher when performance is not the voluntary act which uneventfully flows from a fair bargained for exchange. Chief Judge Paskay observed in a failed performance case that the liquidated damages obligation was imposed for failure to satisfy contract requirements. He stated that, "the amounts owed in liquidated damages are not debts (in that case) 'for an educational loan,' but are contractual penalties as their purpose is not to repay the extension of money, but is to penalize the Debtor. Clearly, contractual penalties are not included among the exceptions to discharge set forth in 11 U.S.C section 523." In re Lipps, 79 B.R. 67,70 (Bankr. M.D. Fla. 1987). But, a triple damage plus interest provision in a national health service scholarship program was considered a valid liquidated damages clause rather than an unenforceable penalty. The parties agreed that the Public Health Service Act, sect. 338D(b)(l)(A) as amended, 42 U.S.GA. sect. 254o (b)(1)(A) controlled the case and not the bankruptcy code. In In re Dillingham, 104 B.R. 505, 511 (Bankr. N.D. Ga. 1989), the court merely listed supporting cases without examining why the liquidated damages clause is valid.

"When the buyer defaulted on his promise to purchase a hotel, the court determined that the stipulated amount of damages was an unenforceable penalty. The court stated that the seller admitted that the "$50,000 figure bore no relation to estimated damages; rather, it was an arbitrary number-high enough to ensure that the buyer would go through with the deal. Budget- Luxury Inn v. Kamash Enterprises, 390 S.E.2d 607, 608 (Ga. App. 1990). Assurance of performance can no longer be assured by padding a liquidated damages provision.

The purpose of a penalty clause is to fix in advance the damages payable in the event of default, to limit the defaulting party's liability and to provide a means of pressure which may coerce the breacher into performing the principal undertaking.[21] The general rule is that a contract with a penalty clause does not create an alternative obligation, which would allow the party to pay the penalty instead of performing the agreed upon obligation.[22] Overcoming its poor reputation, predictability of outcome is the penalty clause's virtue. Despite the need for certainty of result, justice, in many circumstances, prevails. As a Scottish judge has said, "the law will not let people punish each other."[23]

Unlike a penalty, a liquidated damages clause is one which genuinely attempts to estimate in advance the loss which is likely to result from the breach. Agreements for compensatory damages, like penalty clauses, could be made in advance to liquidate any and all potential claims for damages. These liquidated damages provisions, exist when a specific sum of money has been expressly stipulated or agreed to by parties for recovery by either party following breach of contract by the other.[24]

The criteria for liquidated damages in contracts for the sale of goods has been addressed in Section 2-718 of the Uniform Commercial Code.[23] In testing the validity of a liquidated damage clause,[26] one noted commentator lists the following important criteria:

> (1) the amount stipulated in the liquidated damage clause must be reasonable as measured by anticipated or actual harm;
> (2) the use of the liquidation clause must be reasonable because of the difficulties of proof...
> (3) the use of the clause must be reasonable because of the nonfeasibility of otherwise obtaining an adequate remedy...
> The plain meaning of subsection 2-718(1), however, is that a liquidated damage clause is valid if it is reasonable. That

[a]G. Treitel, Remedies for Breach of Contract, A Comparative Account 212-213 (1988).

[a]*Id.* at 214.

"Robertson v. Driver's Trustees (1881) 8 R. 555, 562.

"Hartford Fire Insurance Company v. Controltec, Inc., 561 So.2d 1334, 1335 (Fla. App. 5 Dist. 1990).

"Section 2-718, Liquidation or Limitation of Damages; Deposits,

(1) 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.

St Dow Corning Corp. v. Capitol Aviation, Inc. v. North Rockwell Corp., 411 F.2d 622 (7th Cir. 1969) in which the court upheld liquidated damages where the seller breached by failing to deliver a new, specially built airplane.

> is the single test of validity...even though one or more of the elements listed in subsection 2-718(1) is not present."

Courts view the UCC test as requiring a general reasonableness.[2]* Relative bargaining power still plays an important role in the formation of contracts. Unlike the commercial contract situation, in consumer cases, buyers do not customarily have the opportunity to negotiate for the inclusion of a liquidated damage provision[29]. Perhaps because of the code's terse treatment of the subject, most courts have relied on common law principles dating from the First Restatement[30] in discussing liquidated damages.[31] However, the Second Restatement[32] was drafted to harmonize with section 2-718 of the Code.[33]

The payment of liquidated damages does not make an agreement into an alternative contract[34]. In an alternative contract, the performance of either alternative completely discharges the promisor's duty and entitles the promisor to the performance that was promised in exchange.[33]

The common law principles for distinguishing penalties and liquidated damages essentially fail to eliminate the lingering doubt as to which category the clause will fall.[34] Under these circumstance there is an undue premium for draftsmanship.[37] To further the likelihood of its enforceability, parties should always draft a liquidated damages provision as narrowly as possible so that the agreed sum relates to a particular, specified breach.[3]*

^awldand UCC Series Section 2-718:01 (1982).

^Northwestern Motor Car, Inc. v. Pope, 187 N.W.2d 200, 202 (1971).

"Anderson, *Liquidated Damages under the Uniform Commercial Code,* 41 SW. L. J. 1090 (1988).

"Statutes have also been enacted to provide legislative guidance beyond common law principles. *See* California Civil Code sec. 1671 and sec. 3389. Section 1671 favors the enforcement of liquidated damages provisions except against a consumer in a consumer case. Section 3389 provides that liquidation of damages is not a bar to specific enforcement.

"Note, *I irpiiAntmA Damages Recovery Under the Restatement (Second) of Contracts,* 67 CORNELL L. REV. 862, 873 (1982).

"Section 356 of Restatement (Second) of Contracts (1979) 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 lou 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.

"Restatement (Second) of Contracts sec. 356 reporter's note (1979).

"Stewart v. Griffith, 30 S.Q. 528, 217 U.S. 323, 54 L-Ed. 782 (1910).

K*See* 5 Corbin on Contracts, sec. 1070.

* Treitel, *supra* note 21, at 233.

[57] Dunbar, Jr., *Drafting the Liquidated Damage Clause-When and How,* 20 OHIO ST. L. J. 221 (1959).

* Anderson, *supra* note 29, at 1083,1110.

CONTRACT BENEFIT, DAMAGES, AND CONSIDERATIONS OF FAIRNESS

Contractual fairness is very difficult to achieve. Inevitably one party may have some noticeable advantage. However, adequacy of consideration does not preoccupy judicial concerns. The civil dockets do indicate that, amazingly enough, the judicial system spends considerable time in overseeing and preserving the instances where the individual is shielded from the effects of an unfair bargain.[19] The mistake," undue influence,[41] duress,[42] or presumed lack of judgment due to immaturity[43] are debilitating factors which prevent a fair exchange on an equal footing.

But why would society paternalistically shield these transactions and yet leave undisturbed other bad bargains? The inane person can find no relief from the effects of a bad bargain since stupidity is a personal quality over which a person has control. One can seek information so that one can effectively conclude an informed, bargained for exchange. If one fails to do so, one's laziness and stupidity cannot be excused.

Occasionally, the execution of a contract can only be realized by allowing one contractual party more bargaining power. When such exceptions arise, legal fictions, such as the alternative performance doctrine, justify the resulting advantage.[44]

Fraudulent conduct[45] which produces misinformation, on the other hand, cannot be avoided unless all members in society engage in a form of mass paranoia whereby the validity of all information would be questioned. Under these conditions, meaningful social intercourse could not exist.

" But DO« all bad bargains are unfair. The Fifth Circuit upheld a mortgagee's refusal to release its lien on prepayment, when it stated, "Our entrepreneurial economic system does not exact moral scruples in deals between parties of equal bargaining power." Houston N. Hosp. Properties v. Telco Leasing, Inc., 680 F.2d 19,22-33 (5th Cir. 1982). The court was influenced by notions of freedom of contract but this is not a case of liquidated damages. Claims for liquidated damages were allowed in In re United Merchants & Mfrs., Inc., 674 F.2d 134,144 (1982) because the contract provisions were negotiated by equally sophisticated parties bargaining at arm's length.

[40] Beachcomber Coins, Inc. v. Boskett, 400 A.2d 78 (1979).

[41] Odorizzi v. Bloomfield School District, 54 Cai. Rptr. 533 (1966).

[n] Totem Marine T. & B. v. Alyeska Pipeline, 584 P.2d 15 (1978).

[45] Fisher v. Cattani, 278 N.Y.S.2d 420 (1966).

[44] The "take or pay" gas purchase contract is enforceable to allow the provider the means to raise money necessary to improve and expand its service and to discharge its public duties. The contract promise, in this context, imposes alternative obligations instead of unenforceable liquidated damages. Sabine Corp. v. ONG Western, Inc., 725 F. Supp. 1157, 1185 (W.D. Okl. 1989).

[43] A failure to speak when there is a duty to do so may also be fraudulent. Sorrell v. Young, 491 P.2d 1312 (Wash. App. 1971).

For a society to function, there must be a basic level of fairness and trust so that persons may enter into contractual agreements, which they feel obligated to keep.[46] Ethical considerations interrelate with notions of basic fairness and reasonableness. If one upholds the basic Kantian principles of trust and respect, it would be wrong to make a promise and then to break it.[47] But when a promise is broken, there is no requirement that the dispute be resolved solely in accordance with that promise.[4]®

WHEN TRUST FAILS, TURN TO LITIGATION: ONE HYPOTHETICAL AND FOUR EXAMPLES OF CONFLICT IN LIFE[49]

Freedom to contract and fairness as to the value of a bargained for exchange are terms agreed among the contracting parties over which society may or may not patemalistically interfere. Society will generally not question the adequacy of consideration. And yet, at times, liquidated damage clauses in agreements may be viewed by society as unenforceable penalties.

1. The Hypothetical Case of the Breaching Farmer

Assume that a farmer promised to sell and deliver a quantity of wheat for $10,000 to a buyer on a day certain. The buyer, dependent upon such delivery but fearful of possible non-delivery, negotiated a "stipulated damage clause" to minimize the loss to his expectancy interest. This modest clause provided for a payment of $12,000 by the farmer if the wheat were not delivered on that date. The stipulated amount, in approximating the buyer's frustration, becomes a ransom that represents, in the minds of both parties, a "substitute" for performance.

The farmer breached when wheat was selling at $11,000. The judge, after perhaps consulting a hornbook,[50] will solemnly caution the buyer that the law will not enforce a penalty but will honor a liquidated damage clause only

[u] One can observe that ethics is the hidden constant behind the drama for enforcement of stipulated contractual terms. A state, said Justice Cardozo, "is free to regulate the procedure of its courts in accordance with its own conception of policy and fairness unless in so doing it offends some principle of justice so rooted in the traditions and conscience of... (society)' Palko v. Connecticut, 302 U.S. 319,82 LEd. 288,58 S. a. 149 (1937). Federal courts refer to state law but more consideration is involved. For example, the concept of equity governs the federal bankruptcy court. It views itself as "being essentially a court of equity...(that) will not enforce a liquidated damages clause that is in reality a penalty." In re O.P.M. Leasing Services, Inc 23 B.R. 104,110-111 (Bankr. S.D.N.Y. 1982).

[.7]C FRIED, CONTRACT AS PROMISE 15 (1981).

** Fried, *supra* note 47, at 27.

* This exam Die and these recent cases are also included in Professor Wiesner s research and writing, currently under preparation, on the liquidated damage doctrine. This endeavor contains a detailed discussion on additional policy concerns.

"L. SIMPSON, CONTRACTS 399-401 (1965).

when the court finds that the harm caused by the breach is incapable or difficult of estimation and the amount of liquidated damages is a reasonable forecast of just compensation.[51]

What public policies, ethics and rationales inhabit that principle? The wheat purchase might be labeled a "garden variety" legal example yet the presence of stipulated damage clauses permeates commercial and personal adventures alike. A reading of the new decade's decisions quickly supplies the examiner with a cross section of its presence. Four unassertive situations, involving a child custody promise,[52] a fire alarm system,[53] an ex-partner's covenant not to steal clients[54] and a contractor's promise to quickly construct a city reservoir,[55] testify to the relevancy and interest of contracting parties in the use of the stipulated damage clause. Each application for denial or approval admits the observer to an appreciation of the variety of experiences suffered by the clause.

2. The Terror of Custodial Disputes

Liquidated damage clauses appear in many contexts other than just commercial ones. For example, an Arizona case concerned a community property settlement in which performance was secured, or so the enforcing party hoped, by a clause that would be implemented if a breach occurred.

AlbinJ[6] involved a post divorce dispute. A father, in default of his support payments, promised to surrender his visitation rights if his ex-wife agreed to waive all support payments. It was important to her that this promise be kept. To ensure compliance, they stipulated that if he should breach his part of the agreement, he would pay all back alimony plus $1,500 in attorney's fees.

For fifteen months, he faithfully performed this agreement until he decided it would be more advantageous for him to forego his contractual obligation. The husband initially benefitted from the agreement because, as a debtor in bankruptcy court, his debts included non dischargeable child support obligations,[57] consisting of a ten month arrearage, which totaled $3,000. The father, when his financial situation changed, felt bold enough to breach his promise by seeking restoration of his visitation rights.

[51] In the last decade of the century, courts still state the black letter law generally with such language. *St* Advance Tank £ Const. Co. v. City of DeSoto, 737 F. Supp 383 (N.D. Tex 1990).

[52] AJbins v. Elovitz, 791 P.2d 366 (Ariz. App. 1990) hereinafter cited as Albins.

[55] Hartford Fire In*, v. Architectural Mgt., 550 N.E.2d 1110 (III. App. 1990) hereinafter cited as Hartford Fire Insurance.

[54] Holloway v. FAW, Casson & Co., 572 A.2d 510 (Md. 1990) hereinafter cited as Holloway.

[55] Advance Tank & Const. Co. v. City of DeSoto, 737 F. Supp. 383 (N.D. Tex. 1990) hereinafter cited as Advance Tank.

[54] S«e note 52.

[57] 11 U.S.C sect. 523(a)(5)(B).

In pursuit of her contractual remedy, the mother pressed for enforcement of the stipulated damage provision. The appellate court, in refusing enforcement, stated:

> ... that the clause allowing the respondent (mother) to withdraw her waiver of support payments thus causing all waived support to be due, and requiring the payment of her attorney's fees in the sum of $1,500 is nothing more than an *in tenorem* clause designed not as a reasonable forecast of just compensation, but designed to threaten the petitioner and deter him from reinstating visitation.[5]®

Interestingly, the doctrine of freedom of contract is restrained by a lethal judicial weapon when a court, in striking down damages agreements, characterizes the stipulated clause as *in terrorem* because promisors are discouraged from avoiding their contractual obligations. Without any explanation, the court stated "It is clear...(the) clause...(is) not... a reasonable forecast of just compensation."[59] But, the curtailment of visitation privileges carried such significant value with the mother that the liquidated damages represented all the child support to which she was entitled but waived.[60] This consideration was never challenged as unreasonable. The court quickly noted that the liquidated damage amount was approximately $9,300 and that the father was the beneficiary of substantial community income.[61] How can this amount of money, which represents his financial gain, be viewed as an unenforceable penalty? Perhaps, the unemphasized principle[62] is not freedom of contract but a stronger public policy in protecting the best interest of the child.[63]

3. The Late Reservoir

The next case, *Advance Tank*,[6]* highlights the indicted clause in a more familiar environment. In that litigation, a building contractor promised to construct a reservoir for a city. The contract was awarded not to the lowest bidder but to the contractor who offered the earliest completion date.

[51] Albins v. EJovitz, 791 P.2d 366, 369 (Ariz. App. 1990).

[n] *I<L*

[u] *IcL* at 367.

"/<£ at 368.

"The estrangement of parent and child should be avoided whenever possible. In re Duclcworth, 188 Pa. Super. 232,146 A.2d 365, 367 (1958).

"The right of visitation should not be denied unless the court is convinced that visitations are detrimental to the best interests of the child. Radford v. Matczuk, 223 Md. 483, 164 A2d 904, 908 (1960).

"5« note 55.

Unlike irrelevant boilerplate on many standard contracts, the clause anticipating breach was specifically crafted to meet the city's need for the project's timely completion. In fact, a $51,936 premium was being paid for contract performance at least 90 days earlier than the arrangement offered by the lowest dollar bidder. The stipulated damage clause provided for a $500 per day assessment for each day of delay.

In seeking to strike down the clause, the contractor submitted a number of reasons which showed that the agreed figure did not constitute a reasonable forecast of just compensation. The arguments were almost persuasive. At the outset, the city failed to estimate the actual damages, if delay were to prevent timely completion of the project. Furthermore, the city casually chose the stipulated damage amount after consulting with its engineering firm. Its engineers then mechanically copied the number from a government chart that contained estimates based solely on the cost of the project. And, finally, no real damages could be expected from a nonoperating reservoir, which did not contain water or generate electricity until long after the specified completion date.[65]

The clause in *Advance Tank* was sustained despite a formidable, doctrinal assault by the "reasonable forecast" standard,[66] a variant of the "in terrorem" argument. The standard directs the court to compare the stipulated amount against legally recoverable damages awarded in such cases. Remarkably, damages are set, not in fulfillment of the parties' expectations, but according to the court's expectation of what it deems to be appropriate judicial relief.

Under these circumstances, damages for delay in the completion of a construction project is viewed generally as the fair market rental value of the structure for the period of delay.[67] Obviously, in the *Advance Tank* situation, such a standard would present practical difficulties. Simply, how does one determine the fair rental value of a municipal reservoir? The court considered such a mission to be "inherently difficult if not impossible."[68]

When released from the parameters of a traditional "damage measure" approach, the stipulated damage clause's applicability appears more viable but not assured. The court next considered the maxim, "a liquidated damages provision is to be considered in light of the circumstances as the parties perceived them at the formation of the contract, and not as they exist when the contract was performed (or breached) and the damages occurred."[69] At the time the contract was formed, belief prevailed that the reservoir would be

"Advance Tank *SL* Const. Co. v. City of DeSoto, 737 F. Supp. 383, 384 (N.D. Tex. 1990). "/<£ Curiously, though, a reasonable forecast conceivably could involve such a large sum of money, which payment would functionally be punitive in effect, while also being compensatory in nature.

·7Ryan v. Thurmond, 481 S.W.2d 199, 206 (Tex. Civ. App. 1972).

"Advance Tank & Const. Co. v. City of DeSoto, 737 F.Supp. 383, 384 (N.D. Tex. 1990). *"Id.*

operational on the date specified for completion. In supporting the clause, the court dismissed the last obstacle, when it observed that the stipulated amount or formula was not facially excessive.

> ...the Court cannot say that the amount of liquidated damages was grossly excessive, even though Defendant (the city) appears not to have suffered any actual damages due to the delay....In any case, a liquidated damages sum may be greater than the actual damages without the sum being struck down as a penalty.[70]

In this case, the court painstakingly upheld freedom of contract and, coincidentally, relieved the taxpayer from any potential costs incident to delay in completion of the project.[71] Despite presenting plausible arguments, the breaching party failed to meet its burden to invalidate the clause.[72]

4. The Mathematics of a Failed Partnership

The facts in *Holloway*[73] become less arguable when one considers the particular class of promisor involved and the precedential presence of a sophisticated but familiar damage formula used among partners in withdrawal situations.

A former partner's promise not to compete was policed by a stipulated clause that provided for damages if the withdrawing partner were to perform any services for a client of the firm. The damages were calculated as the amount equal to the firm's billing of the client for the last twelve (12) months preceding that engagement. The court cited a number of decisions which have sustained that method of calculating liquidated damages.

> Some of these decisions, employing substantially the (same) rationale ..., have rejected attacks which were based on the penalty argument....Other courts have upheld the enforceability of these clauses without even addressing whether the clause was a penalty.... We hold that the fee equivalent provision is a valid liquidated damage clause.[74]

"At

[71] Precedent existed for promoting the public interest in a similar situation. The court in Advance Tank relied on an earlier case, which upheld a covenant to pay a fixed sum as liquidated damages upon breach of an obligation to furnish public utilities to cities. City of Marshall v. Atkins, 60 Tex. Civ. App. 336,127 S.W. 1148,1151 (1910).

''The burden to invalidate the liquidated damages provision rests on the party who seeks to avoid it. Commercial Union Ins. v. La Villa Sch. D., 779 S.W.2d 102,106 (Tex. App. 1989).

''See note 54.

''Holloway v. FAW, Casson & Co., 572 A.2d 510, 525-526 (Md. 1990).

The strength of precedent evinces judicial approval not for any particular formula but a predisposition for approving a calculation because of its position in a familiar setting. This result is readily predictable if one focuses on the mind set of judges, who will enforce almost reflexively any stipulated formula for damages that simulates the judicial remedy.

Already attracted to the clause, the court in the *Holloway* case applied a test against the stipulated amount to justify its enforcement. The analysis involves whether (1) the clause provides in clear and unambiguous terms a certain sum, (2) the amount is reasonable compensation for damages anticipated by the breach, and (3) the measure of damages has been fixed prior to breach and cannot be altered to correspond to actual damages determined afterwards.[75]

In this situation, losses continue for each year the departing client would otherwise have remained a client. To establish with reasonable certainty the dollar amount of actual losses is very difficult if not impossible. Still, there is a need to quantify the value of the client to the firm as a means to determine ongoing economic losses. The stipulated damages amount addressed that concern by incorporating into the measure of damages the basis on which accounting practices are bought and sold.[76] By overcoming this significant hurdle, the court finally accepted the validity of the liquidated damage clause.

Without proving any damages, the former partner attempted to absolve himself by claiming that, prior to his departure, his partners misapplied the agreement pertaining to a salary dispute.[77] The court was unwilling to police the firm's internal management by getting involved in this nominal squabble.[7]' Absent provable irregularities, the partners had, by agreement, reasonably regulated themselves.[79]

5. Woeful Amount of Stipulated Damages

A competing concern involves the situation where the stipulated amount may be notoriously inadequate as opposed to being excessive and penal in nature.*[0] Certain special types of undertakings such as security and fire

[7] *Id.* at 525.
[71] *id.*
[77] *Id.* at 527.
[n] *l<L* n.7.
Id. at 526. The fee equivalent provision is considered a valid liquidated damage provision.

"The effect of underliquidaiion *it* to limit liability. Potentially, the clause could be invalidated as an unreasonable, penal liquidated damage clause. Alternatively, the clause, for various policy reasons, may be upheld as a valid limitation of liability. The distinction between the two is sometimes very difficult to draw. Note, *Contractual Limitations of Contract Liability,* 47 IOWA L REV. 964 (1962). Again, there appears to be a general willingness to allow parties to protect themselves by Umiting their liability to a reasonable amount. 5 Corbin, Contracts sect. 1068, at

alarm cases form this situation in which the results are peculiarly uniform. These inadequate settlements for breach are enforceable against the party who is the beneficiary of the clause.

In the *Hartford Fire Insurance* case,[81] the contract in dispute contained a liquidated damages arrangement for breach that limited liability to six times the monthly connection fee. A breach occurred when the alarm company, which maintained a fire-alarm receiving panel in a school, delayed in notifying the fire department.[82] Delay in sending the alarm caused damage, but the lower court upheld the clause and restricted the school to the stipulated damages of $90, a woefully inadequate compensatory sum for the injury sustained.

The appellate court found no reason to disturb the award.

> In the instant case, the liquidated damage provision was clear and explicit, limiting defendant's liability to six times the monthly fee. Moreover, there was no evidence of fraud, and there was no legislative directive to the contrary.[83]

To justify the gross inadequacy of its decision, the court felt vindicated by supporting freedom of contract.*[4] After all, the parties freely entered into their bargain. No finding of fact could support any inference of improper bargaining. Finally, the court concluded its exploration of the realities of consent by focusing on unconscionability:

> An unconscionable bargain is one which no person in his senses would make and which no fair and honest person would accept....The term unconscionable encompasses the absence of meaningful choice by one of the parties as well as contract terms which are unreasonably favorable to the other party.[85]

In the court's analysis, there is a greater calculation involved than just simply characterizing a transaction as unconscionable:

> In evaluating liquidated damage provisions, courts must balance the interest in compensating individuals for their

826 (1951). "*Sse*
note 53.

"Hartford Fire In*, v. Architectural Mgt., 550 N.E 2d 1110,1112 (111. App. 1990).

°*I<L* at 1114.

"Where the stipulated sum is less than the loss suffered, the penalty clause may operate in effect as a limitation of liability. G. Treitel, *supra* note 21 at 209.

"Hartford Fire Ins. v. Architectural Mgt., 550 N.E 2d 1110,1114 (I1L App. 1990).

> injuries and requiring tortfeasors to pay the damages which their conduct has caused against the interest in freedom of contract, including the freedom of parties to a contract to allocate risk of loss.... In striking this balance, we find that the liquidated damage provision at issue here was not unconscionable, and the parties were free to allocate their risk of toss as they saw St.*[6]

The parties freely agreed that the alarm company was not an insurer.*[7] If, in such a case, the liquidated damage provision were ruled invalid, the entire alarm company industry would be threatened and, as a further disservice to the customer, affordable monitoring costs would cease to exist.

CONCLUSION

The selective enforcement of liquidated damage clauses betrays society's decision that freedom of contract shall remain unimpaired as long as its needs are met. These four recent decisions offer the examiner the various reasons that moralists, policy makers and jurists offer in supporting or denying the promisee's due, which is the execution of the agreed upon consequences for breach. To uncover the considerations underlying the judicial reaction to this transaction, the social critic might encounter a mix of public policy, legal history and a noticeable amount of curious reasoning**.

[6] *Id.* at 11X5.

[7] *Id.* at 1112.

...in fact the disposition of the courts has been, in whatever language they cloaked their reason, to consider whether when the contract was made the sum fixed as a liquidation of damages was a fair estimate of the probable injury that would be suffered." Committee of the Association of American Law Schools, *supra* note 12, at 107.