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Liquidated Damages

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L I Q U I D A T E D D A M A G E S

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Parties upon entering into a contract often fix the amount of damages to be paid by one to the other for its breach, and the courts sustain such agreements, saying, "that it is competent for persons entering into an agreement to avoid all future questions as to the amount of damages which may result from a violation of the agreement, and agree upon a fixed sum to be paid to the party who alleges and establishes the breach ; but such an agreement should be either plainly expressed in writing or exist by necessary implication from the true nature of the transaction." The amount thus fixed by the parties is called liquidated damages.

The important question in regard to them is to distinguish between them and penalties, or in other words

is the amount fixed by the contract to be regarded as liquidated damages or as a penalty ? The importance of determining this point depends upon the rule of law that when the damages are stated or liquidated, as it is termed, the amount stated is the precise sum recovered or the measure of damages in the particular instance. Whereas in case of a penalty the amount is not so fixed the amount named being only as security of the principal sum or of the actual damages sustained.

One would think that upon a question which so often arises that the rules governing, would be well settled and yet it is just the reverse, or in the words of Judge Earl in Kemp v. Knickerbocker Ice Co., 69 N.Y. 58, "the cases cannot be harmonized and they furnish conspicuous examples of judicial efforts to make for the parties

wiser and more prudent contracts than they have made for themselves".

And again Judge Ruggles in 9 N.Y. 551 says, "the ablest judges have declared that they felt themselves embarrassed in ascertaining the principle upon which cases like the present were founded. They have said that the law relating to liquidated damages has always been in a state of great uncertainty and has been occasioned by courts endeavoring to make better contracts for parties than they have made for themselves."

Although the above is true to some extent, yet I think, that upon a thorough sifting of the cases certain fundamental rules are obtained which are described in 16 N. Y. 471 by Judge Shankland as "a series of artificial rules peculiar to contracts of this character, which

while they ostensibly profess to comply with the fundamental canons of construction appertaining to legal science, contrive to contravene them by artificial distinctions and limitations".

The object of this thesis is to attempt to reduce the law, from a confused array of individual cases to a systematic collection of rules.

When called LIQUIDATED DAMAGES.

In such a case if, independently of the stipulation, the damages would be wholly uncertain and incapable or very difficult of being ascertained except by mere conjecture, then the damages will usually be considered liquidated if they are so denominated in the instrument, and the jury is bound in giving its verdict to confine

itself to the sum fixed ; unless it be so grossly disproportionate to the actual injury that a man would start at the bear mention of it, (Clement v. Cash 21 N.Y. 253),or unless it is so extortionate or unjust as to raise the presumption of fraud (3 E. D. Smith 118) ; or unless the damages under some circumstances would be merely nominal ; although the sum may appear excessive (Clement v. Cash 21 N. Y. 253); or the payment of a smaller sum is secured by a larger (22 Wend. 202).

Reasons for the rule. In Crisbee v. Balton 3 Car. & P. 240. Best Ch. J. says, "that parties to contracts from knowing exactly their own situation and objects can better appreciate the consequences of their failing to obtain other objects than either judges or juries, and that, if a contract clearly states what shall be paid by

the party who breaks it, to the party to whose prejudice it is broken, the verdict in an action for the breach should be for the stipulated sum : that a court of law has no more authority to put a different construction on the part of an instrument ascertaining the amount of damages, than it has to decide contrary to any other of its clauses."

A court of law possesses no dispensing powers ; it cannot inquire whether the parties have acted wisely or rashly, in respect to any stipulations they may have thought proper to introduce into their agreements. If they are competent to contract with the prudential rules, the law has fixed as to parties ; and there has been no fraud, circumvention, or illegality in the case, the court is bound to enforce the agreement. Or in the

words of Jacquith v. Hudson 5 Mich. 123 "where from the nature of the contract and the subject matter of the stipulation, for the breach of which the sum is provided, it is apparent to the court that the actual damages for the breach are uncertain in their nature, difficult to ascertain, or impossible to be estimated with certainty; and where the parties are more intimately acquainted with all the peculiar circumstances and therefore better able to compute the actual or probable damages than courts or juries from any evidence which can be brought before them, in such cases the law permits the parties to ascertain for themselves, and provide in the contract the amount of damages which shall be paid on a breach, and adopt their computation as the best and most certain mode of ascertaining the actual damages, or what sum

will amount to a just compensation."

But even the words "liquidated damages" are not conclusive, and the courts will inquire into the intention of the party by examining the other provisions of the contract, the subject matter, the nature of the contract, the surrounding circumstances, the ease or difficulty in ascertaining the amount of damages, the situation of the parties, and then from the whole decide whether the sum shall be treated as liquidated damages or as a penalty fixed to secure performance of the contract.

The policy of the law will not permit parties to make liquidated damages by calling them as such in their contract which in its nature is clearly a penalty or a forfeiture for non-performance. While it allows

them in certain cases to fix their own damages, it will in no case permit them to evade the law by agreement.

Performance of many acts. Where the contract stipulates for the performance of many acts and for the payment of a sum as liquidated damages for the breach, if the acts to be done are of equal degree and importance it is clear that the sum will be held as liquidated damages ; but when the acts stipulated for are of different degrees of importance there is more difficulty. Several cases lay down the rule that when a contract binds the parties to do several things of different degrees of importance, and the sum stated is made payable for the non-performance of any or either, it is a penalty. There are also cases which qualify the above rule in this respect, that when the sum which is to be a security

for the performance of an agreement to do several acts, will in cases of breaches of the agreement, be in some instances too large and in others too small a compensation for the injuries thereby sustained, the sum is to be considered a penalty.

In 2 Story on Contracts 658, the rule is laid down in the following words : "where a sum certain is stipulated to be paid for the breach of any one of several covenants, the sum although called stipulated damages shall be construed to be a penalty, if damages for the breach of any one of the covenants is capable of being ascertained by a jury."

But there are cases which hold that the above rule has no solid foundation in principle, and the doctrine no countenance in the cases Astley v. Weldon and Kemble

v. Farren, from which it is supposed to be derived.

In Cotheal v. Talmage 9 N. Y. 556, the court says, "But I do not understand either of these cases as establishing any such rule. The principle to be deduced from them is, that where a party agrees to do several things one of which is to pay a sum of money and in case of failure to perform any or either of the stipulations, the larger sum is to be regarded in the nature of a penalty ; and being a penalty in regard to one of the stipulations to be performed it is a penalty as to all."

In regard to this rule Judge Christiancy in 5 Mich. 123 says, "As a rule of construction or interpretation of contracts it is radically vicious and tends to a confusion of ideas in the construction of contracts generally. It is this more than anything else which has pro-

duced so much apparent conflict in the decisions upon this whole subject of penalties and liquidated damages. It sets at defiance all rules of interpretation by denying the intention of the parties to what they, in the most unambiguous terms, have declared it to be and finds an intention diametrically opposite to that which is clearly expressed."

But there is some reason for the rule. It is based on the theory that when men designate one standard of compensation for violations of contracts of different degrees of importance, or the violation of one of which would be attended by a loss entirely disproportionate to the former, they cannot have given the matter that careful, serious consideration, which they should and could not have made the probable loss the subject

of fair and actual calculation.

But on the whole the rule laid down in Kemble v. Farren has I think, met with approval. The facts of the case were as follows : an actor made a contract not to play with any one but the plaintiff for five seasons, and the latter promised to pay the former 3£ 10s. each night, and some other small expenses. The bond provided that if either party violate any of the stipulations he should forfeit 1,000£ to the other, not by way of penalty but as and by way of liquidated damages. The defendant refused to act the second season and a verdict was given the plaintiff for 750£ notwithstanding the strong language of the instrument. On a motion to raise the amount to 1,000 £ the question came up, and Tindall J. held it to be a penalty to secure the

performance of the various stipulations, and that the words employed, were either inserted by mistake or for the purpose of deception, and to evade the well-known policy of the law in regard to penalties.

When NOT called LIQUIDATED DAMAGES.

If the sum stated to be paid be not called "stipulated", "liquidated","fixed" or "settled" damages, or some other term synonymous, there is a strong tendency and preference of the law to regard it as a penalty and not as liquidated damages, especially where there is any doubt in regard to the intent of the parties, which always prevails when satisfactorily ascertained, or where the contract is for the performance of several stipulations of different degrees of importance, and one large sum is made payable on the breach of any of them, even

the most trivial, the damages for which can in no reasonable probability amount to that sum ; and it may safely be assumed that generally, when the sum is unaccompanied by any terms indicating that parties regarded it as penal, if the case affords no other measure of damages equally satisfactory which are uncertain and depend upon the discretion of the jury in a large degree, and it is apparent that they have been made the subject of actual and fair calculation and adjustment between the parties, the courts will regard such sum as stipulated damages.

Test for determining whether penalty or liquidated damages . All authorities agree that the question is to be determined in accordance with the intention of the contracting parties. Each case must depend upon its own peculiar and attendant circumstances, and the certainty

or uncertainty as to the extent of the damage may then become the most reliable criterion in the attainment of the desired result. In the earlier cases, says Agnew J. 48 Pa. St. 450, the courts gave more weight to the language of the clause designating the sum as a penalty or as liquidated damages. The modern authorities attach greater importance to the meaning and intention of the parties. Yet the intention is not all controlling, for in some cases the subject matter and the surroundings of the contract, will control the intention where equity absolutely demands it.

WHEN PENAL WORDS EMPLOYED.

When the amount named is designated in the instrument by such terms as "forfeit", "forfeiture", "penalty", "penal sum", "fine", "under a penalty", or "under a for-

feiture", and the courts can see no other intention in the instrument they are inclined to regard such a sum as a penalty, whenever it can be properly done, in order that the question of compensation may be given to the jury and justice may be done to the injured party. In Tayloe v. Sandford, 7 Wheat. 13, Marshall Ch. J. said, "In general a sum of money in gross to be paid for the non-performance of an agreement is considered as a penalty, the legal operation of which is to cover the damages which the party in whose favor the stipulation is made may have sustained from the breach of the contract by the opposite party. It will not of course be considered as liquidated damages, and it will be incumbent on the party who claims them as such to show that they were so considered by the contracting parties. Much

stronger is the inference in favor of its being a penalty when it is expressly reserved as one. The parties themselves denominate it a penalty, and it would require very strong evidence to authorize the court to say that their own words do not express their own intention."

And in general it may be said that while the terms mentioned are generally regarded as furnishing almost conclusive evidence of an intent to describe a penalty, the weight to be given to such phraseology depends entirely upon its connection with the other parts of the contract, the subject matter and the situation of the parties, and if the sum be expressly agreed to be paid on such terms as to admit of no doubt, because of the nature of the case the uncertainty of proof, or the difficulty of reaching damages by proof have induced them to make damages the

subject of previous adjustment, that the design of the parties was that it should have been regarded otherwise than as a penalty the language will be disregarded and the sum held to be liquidated damages. This rule was applied in Jacquith v. Hudson 5 Mich. 123, where the provision, "under forfeiture of $1,000 to be collected by said Hudson as his damages" was held to be liquidated damages; and even the word "penalty" has been held a proper one for explanation and change. (Dwindell v. Brown 54 Me. 472). In Streeter v. Williams 48 Pa. St. 450, the court in speaking of the subject said :"Upon the whole the only general observation we can make is that in such a case we must look to the language of the contract, the intention of the parties as gathered from all its provisions, the subject matter of the contract,

and its surroundings, the ease and difficulty in measuring the breach in damages, and the sum stipulated and from the whole gather the view which good conscience and equity ought to take of the case."

B O N D S.

While a bond is prima facie a penal obligation, the sum inserted therein has sometimes been treated as liquidated damages, but generally only when the intent to treat them as such is manifested by indicative terms.

CONTRACTS IN RESTRAINT OF TRADE.

While the courts in cases of other contracts have at times shown no hesitation in holding sums to be penalties even when expressly called liquidated damages, they are inclined to deal with such a sum mentioned in a con-

tract in restraint of trade as liquidated damages, when not expressly denominated in the instrument as penal, and although such sums are not described as liquidated damages. The reason being that in such a contract the damages are necessarily uncertain in amount and not easily ascertainable by a jury.

MISCELLANEOUS CONTRACTS.

Stipulations fixing the damages for breach of marriage promises, and also in the case of building contracts or of promises in a contract not to reveal secrets, etc., or in the case of contracts to convey real estate and personal property have been frequently sustained.

CONTRACTS FOR THE SALE OF GOODS.

The question whether stipulations fixing the damages for the breach of a contract to deliver goods will be upheld is a doubtful one. It has been said by some that they will not as the sum fixed must necessarily be a penalty, since the legal measure of damages can always be ascertained, being in fact prescribed by law, namely, the difference between the market price and the price agreed to be paid. It is plain that such a view would be sound in many cases, but it is equally plain that there is another class of cases to which this reasoning nor conclusion can apply. In many contracts for the purchase and sale of personal property there are no such means of accurately measuring the damages which result from a violation. If the agreement is for the

sale generally of things of a certain kind or description, on a default the vendee can as a rule, go into the market and purchase other articles answering to the description. The measure of damages would then be the difference between the amount agreed to be paid and the market price, and the amount stipulated would of course be considered a penalty. But where the agreement is for the sale and delivery of certain specified things, in some cases the above rule cannot be applied, and so the certain sum stipulated may be considered liquidated damages and not a penalty. (Shiell v. McNeil 9 Paige 101) The true doctrine in this class of contracts is doubtless to let each case be determined by its own peculiar circumstances.

SPECIALTIES AND PAROL CONTRACTS.

Some of the cases have attempted to make a distinction between contracts under seal and parol contracts. It is sufficient to say that this distinction has met with very little encouragement from the courts, and in most opinions it is not spoken of at all. The distinction rests upon the doctrine of estoppel in regard to sealed instruments in the matter of consideration which is regarded with very little favor to-day. But it can be justified upon the ground that in the case of sealed instruments the parties may be presumed to have made a closer study of the probable damages in case of a breach than in a parol contract; but I think that this theory is not sustained by observation and experience.

STIPULATIONS OVER AND ABOVE.

In the case of "damages over and above" the actual damages, it has been held by a divided court in Dwinell v. Brown 54 Me. 474, that they can be collected as liquidated damages; but I think that the logic of Judge Appleton's opinion in that case is sound, that liquidated damages are fixed, settled and agreed upon in advance to avoid all litigation as to those actually sustained. They are compensation for and in lieu of actual damages never in addition thereto. The language of the agreement leaves no room for any other conclusion than that the sum fixed is a penalty. It is not for damages by the terms of the contract. It is not therefore a sum agreed upon in liquidation of damages, but is a penalty and must be so regarded.

PART PERFORMANCE.

It is an almost universal rule that part performance and an acceptance thereof is a bar to the recovery of the sum stipulated to be paid on the breach of a contract as liquidated damages. In Wheatland v. Taylor 29 Hun. 14, Macomber J. said, "But going at large into the subject, one consideration we think is decisive against recovery of the sum in question as liquidated damages, namely, there has been a part performance and an acceptance thereof x x x x It is like the case of an obligation to perform two or more independent acts with a provision for single liquidated damages for non-performance. If one is performed and not the other it is not a case for the recovery of liquidated damages."

EFFECT OF PARTIAL WAIVER.

Consent to a partial breach of the contract, such as an extension of time to the offending party does not in any way affect the right of the plaintiff to the recovery of the amount as liquidated damages. The most common way in which partial waiver is brought about is by the plaintiff extending the time of performance to the defendant, and on this subject Sutherland J. in Dearborn v. Cross 7 Cowen 48, remarks, "The enlargement of time is nothing more than a waiver of strict performance. The defendant have solicited the delay cannot urge it as a defense. This would convert an indulgence yielded to his solicitation into a weapon, and the law does not any more than religion justify a return of evil for good or of ingratitude for benefits."