

# Power of Contract and Agreed Remedies

Ian R. Macneil

Follow this and additional works at: <http://scholarship.law.cornell.edu/clr>

 Part of the [Law Commons](#)

---

### Recommended Citation

Ian R. Macneil, *Power of Contract and Agreed Remedies*, 47 Cornell L. Rev. 495 (1962)  
Available at: <http://scholarship.law.cornell.edu/clr/vol47/iss4/1>

This Article is brought to you for free and open access by the Journals at Scholarship@Cornell Law: A Digital Repository. It has been accepted for inclusion in Cornell Law Review by an authorized administrator of Scholarship@Cornell Law: A Digital Repository. For more information, please contact [jmp8@cornell.edu](mailto:jmp8@cornell.edu).

# CORNELL LAW QUARTERLY

---

VOLUME 47

SUMMER, 1962

NUMBER 4

---

## POWER OF CONTRACT AND AGREED REMEDIES

*Ian R. Macneil*†

### INTRODUCTION

Power of contract is one of the two sides of freedom of contract. On one hand, freedom of contract is a freedom from restraint, an immunity from legal reprisal for making or receiving promises. On the other hand, it is not really a freedom of contract, but a power of contract, a power to secure legal sanctions when another breaks his promise.<sup>1</sup>

It is this second side of freedom of contract, the power of contract, to which writers refer when they make statements such as the following: "The non-enforcement of penalties and forfeitures is a limitation on freedom of contract and is based upon the notions of public policy held by courts of equity."<sup>2</sup> The question to be explored is whether there is in fact a clash of policies in nonenforcement of penalties and forfeitures and other agreed remedies. More specifically, in such cases are the functions of the social tool of contract actually in conflict with "notions of public policy held by courts of equity," *i.e.*, prevention of harshness and overreaching? Or is nonenforcement of certain agreed remedies a tacit recognition that the functions of contract can be achieved in those cases in spite of the nonenforcement of those particular remedies? A consideration of the functions of contract will show that the conflict is more apparent than real.

By its nature a power to compel and any basic rights to enjoy such

---

† See contributors' section, masthead p. 631, for Biographical data.

<sup>1</sup> This duality of freedom of contract is analyzed in 6 Corbin, Contracts § 1376 (1951) [hereafter cited as Corbin].

The use of the word "freedom" to describe a power to compel may be confusing, but the usage is not as anomalous as first appears. Contract has been and is an extremely flexible libertarian instrument for arranging social and economic relationships. It has the capacity of utilizing and channeling legal authority so that society can operate with a relative minimum of limitation on the freedom from restraint of its members. In view of the function of contract in the preservation of freedom it is not surprising that rights to its availability came to be known as freedom of contract.

<sup>2</sup> 5 Corbin § 1055; see also § 1057.

power cannot be unlimited, even theoretically.<sup>3</sup> To mean anything, therefore, a power to compel must be defined. How we define power of contract depends upon how we define contract. The language quoted above that the nonenforcement of penalties and forfeitures is a limitation on power of contract suggests a very broad definition of that power and thereby of contract itself. It contains the implication that at least any promise seriously meant is a contract and that failure to enforce such a promise is a restriction on the power of contract. It is certainly possible to define contract as any promise seriously meant,<sup>4</sup> and to hold a refusal to give legal sanctions for breach of any such promise to be an infringement of the power of contract. Under such a definition a refusal to enforce a penalty clause would be an abridgement of the power of contract,<sup>5</sup> just as would be refusals to enforce promises in restraint of trade or to commit crimes, yellow dog contracts, unconscionable contracts, and at least some social promises and promises lacking formal requisites such as consideration.<sup>6</sup> So too, refusals to grant specific performance could infringe the power of contract whenever the ground for doing so is something other than the adequacy of damages.

But is it true, in Anglo-American law at least, that society intends, even in the most general terms, that sanctions be available for all seriously meant promises? or that the goal of contract sanctions is to insure actual performance of promises? In light of the doctrine of consideration and of other prerequisites to legal enforcement of promises, and in view of our predominantly substitutional remedies, *i.e.*, money damages, the answer to both questions is "no."

It is possible to define contract and thereby power of contract in some manner which comes closer to the facts of legal life than the definition suggested above. Any extended discussion, however, of the much debated question, "Why are promises given sanctions?" is out of place here. Nevertheless, the working hypothesis of this article is that promises

<sup>3</sup> Unless, of course, they are concentrated exclusively in one all-powerful individual in the society.

<sup>4</sup> The most common definitions of contract reveal little on this point since they are tautological. For example:

"A contract is a promise . . . for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty." 1 Williston, Contracts § 1, at 1 (3d ed. 1957) [hereafter cited as Williston (3d ed.)]; Restatement, Contracts § 1 (1932).

<sup>5</sup> Others besides Corbin, see note 2 *supra*, having so described it. See, e.g., McCormick, Damages § 147 (1935) [hereafter cited as McCormick]; Brightman, "Liquidated Damages," 25 Colum. L. Rev. 277 (1925). Similar concern is expressed in French law over the apparent threat to sanctity of contract. Benjamin, "Penalties, Liquidated Damages and Penal Clauses in Commercial Contracts: A Comparative Study of English and Continental Law," 9 Int'l & Comp. L.Q. 600 (1960).

<sup>6</sup> Social promises and promises lacking formal requisites may or may not be contracts as defined above since they may or may not be seriously meant.

are given sanctions to protect reliance on promises and to prevent unjust enrichment.<sup>7</sup> A further premise is that expectancies are enforced to protect hidden or unprovable reliance (such as unprovable lost opportunities), to give added protection to reliance, thus encouraging it to occur,<sup>8</sup> and to prevent gain through breach.<sup>9</sup> In terms of these alleged purposes of the courts we can define a contract as follows:

A contract is a promise given legal sanctions adequate (1) to protect proven reliance on the promise by the promisee; (2) to prevent gain by default on the promise,<sup>10</sup> and (3) to effectuate expectancies created by the promise (a) where there may be hidden or unprovable reliance<sup>11</sup> or (b) where socially desired reliance<sup>12</sup> may thereby be promoted.

<sup>7</sup> See generally Fuller and Perdue, "The Reliance Interest in Contract Damages," (pts. 1-2) 46 *Yale L.J.* 52, 373 (1936-37).

<sup>8</sup> *Ibid.*

<sup>9</sup> It is another question whether the factor of potential gain through breach has worked indirectly, in unacknowledged ways. I suggest that it has, and that it has probably been a powerful factor in establishing the promisee's expectancy as the normal and accepted measure of damages for breach of contract.

Dawson, "Restitution or Damages?," 20 *Ohio St. L.J.* 175, 187 (1959).

Of course, promises can be enforced for purposes other than preventing unjust enrichment or protecting and encouraging reliance, hidden or otherwise. Mr. Justice Frankfurter suggests another purpose in *Priebe & Sons, Inc. v. United States*, 332 U.S. 407, 419 (1947). There the Court struck down a clause in a government contract which it held to be a penalty. In a dissenting opinion Frankfurter argued that "if this contract were an ordinary commercial contract subject to the ordinary rules of the law of contract" the clause would be unenforceable. He goes on, however, to point out that "the Government may certainly assure performance of contracts upon which the effective conduct of the war depended by tightening the consequence of non-performance. . . ." See also 5 *Corbin* § 1055. Frankfurter is suggesting that an additional purpose to be effectuated is that actual performance and production be achieved.

In the Communist states where emphasis is on production, breach of a production contract is something more than a failure of a duty to the other party, it is a wrong against the state. In other words production contracts are not thought of as arrangements between autonomous units, in which society's only interest is in providing sanctions to aid in the achievement of certain goals desired by the parties. Rather such contracts are part of an overall social plan of production in which actual performance in accordance with the plan of the state is the goal. This difference in goals leads to quite different attitudes toward penalty clauses in contracts. See Schlesinger, *Comparative Law* 332-335 (2d ed. 1959). Indeed, failure to meet production goals, including, presumably, contractually promised ones, in the past at least, often led to far harsher sanctions than monetary penalties. The increasing availability of specific performance with its potential threat of contempt seems to be moving American contract law in the direction of insuring production rather than of merely protecting and encouraging reliance and preventing unjust enrichment. For review of that trend see Van Hecke, "Changing Emphases in Specific Performance," 40 *N.C.L. Rev.* 1 (1961). In American law, too, the allowance of punitive damages for breach of contract does more than protect the reliance, restitution, and expectancy interests, but such awards are available in only a few situations. 5 *Corbin* § 1077; 5 *Williston, Contracts* § 1340 (rev. ed. 1936-38) [hereafter cited as *Williston* (rev. ed.)]; Simpson, "Punitive Damages for Breach of Contract," 20 *Ohio St. L.J.* 284 (1959). For a recent abortive attempt to give punitive damages for breach of a collective bargaining contract see *United Shoe Workers v. Brooks Shoe Mfg. Co.*, 187 F. Supp. 509 (E.D. Pa. 1960), rev'd 298 F.2d 277 (3d Cir. 1962); noted in 47 *Cornell L.Q.* 112 (1961); 13 *Stan. L. Rev.* 950 (1961).

<sup>10</sup> It may be that this too will call for the effectuation of an expectancy.

<sup>11</sup> Possible hidden or unprovable reliance is most commonly found in promises transferring market risks. It is so common in such transactions that practically no one except law professors and their students even think about it; everyone else simply assumes that an expectancy recovery is the only rational protection of contractors in such cases.

<sup>12</sup> Of course, not all reliance on promises receives the added protection of the en-

This definition sets forth what are, at least arguably, the general purposes of society in enforcing contracts through its courts. It also narrows the definition of power of contract. Power of contract becomes the availability to a promisee of legal sanctions adequate to protect his reliance on the promise, to prevent gain by default, and to effectuate expectancies where there may be hidden or unprovable reliance.<sup>13</sup> Thus, where legal sanctions are not adequate, this power of contract is curtailed. The curtailment is a minor one if he is permitted to use self-help, for example, agreed remedies, to make them more adequate, but the curtailment is a serious one if the legal sanctions are not adequate and he is not permitted to use self-help to make them more adequate. On the other hand, there is no curtailment of his power of contract if he is not permitted to use self-help when the law already gives him sanctions adequate to achieve the purposes listed.<sup>14</sup>

When we consider agreed remedies, the foregoing definition of contract enables us to change our focus from the alleged conflict between a policy favoring freedom of contract (in the power sense) and a policy of preventing harsh bargains. This is advantageous in avoiding the many associations of this conflict with matters having nothing to do with agreed remedies. Instead we can focus on the question: Does this agreed remedy fill an inadequacy of the law in giving protection to the promisee's reliance, in preventing gain by the defaulter and in effectuating expectancies where there may be hidden reliance?<sup>15</sup> If the answer is "yes," the purposes of contract law require giving effect to the agreed remedy. If the answer is "no," they do not.

---

enforcement of expectancies. The phrase "socially desired" is simply a shorthand way to distinguish between that which does, e.g., reliance in commercial transactions, and that which may not, e.g., Johnny's buying a new Cadillac in reliance on a promise by Uncle to give him \$25,000. See the famous dialogue between Mr. Coudert and Mr. Williston, *A.L.I. Proceedings*, Vol. IV, Appendix (1926) 98-99, 103-04.

<sup>13</sup> This definition of power of contract omits reference to legal sanctions adequate to effectuate expectancies for the purpose of promoting socially desired reliance. Although strictly speaking such sanctions should be included to do so would confuse the discussion and lead to question begging. If such notions of social desirability are sufficiently particularized no refusal to enforce an expectancy in the absence of hidden or unprovable reliance would constitute an infringement of power of contract. For example, reliance on a liquidated damage clause is desirable, but reliance on a penalty is not. It is therefore assumed throughout the balance of the article that power of contract does not include the availability of sanctions, the sole purpose of which is to effectuate expectancies in order to promote socially desired reliance. This excision is far less sweeping than at first appears. It is a rare case in which there is reliance clearly recognized as socially desirable, for example, in commercial transactions, which does not also involve hidden or unprovable reliance, for example, possible lost opportunities to enter other transactions. Such cases of course call for the effectuation of expectancies without inquiring into the positive social desirability of the reliance.

<sup>14</sup> It is true of course that the promisee is denied powers which the law might otherwise provide, but they are not powers of contract.

<sup>15</sup> Hereinafter these factors will be referred to as the promisee's reliance, restitution, and expectancy interests.

The following sections will develop the relationship of this definition to penalties and liquidated damages, penal bonds, forfeitures, and other efforts to provide for the consequences of breach, such as clauses concerning specific performance, attorneys' fees, and arbitration.

#### LIQUIDATED DAMAGES AND PENALTY CLAUSES

This section deals with executory clauses,<sup>16</sup> where the stipulated remedy is enforceable only if the court adds its sanctions. This is in contrast to forfeiture clauses in which the defaulter seeks return of something of value. Thus this section concerns plaintiffs wronged by a breach of contract who seek enforcement of a stipulated remedy, or defendants who seek to limit recovery to such an amount.<sup>17</sup>

Is power of contract as defined above infringed by the refusal of the court to enforce a penalty clause? As to the base promise<sup>18</sup> the answer is "no," so long as the court provides sanctions adequate to protect the reliance, restitution, and expectancy interests of the promisee created by that base promise. Yet the penalty clause itself is a promise, and there are no sanctions supplied for its enforcement. Nevertheless, the foregoing interests are generally given adequate legal sanctions even though this particular clause is given none.

For example, assume an obviously unenforceable penalty clause: a promise to pay \$500 as a penalty upon failure to repay a \$100 loan on its due date a year hence. It is most unlikely that the promisee-creditor relies on the penalty clause in such a case because the promisee's reliance is on the base promise to pay the \$100 loan. The promisee may hope for a breach, but by lending money to the promisor on the base promise, he has been willing to rely on it. The penalty is only additional *in terrorem* security for the performance of that base promise. Insofar as the borrower-promisor knows before the due date that the court will not enforce the penalty, the lender-promisee loses that security, and his power of contract is infringed. The reliance on this security, however, seems rather slight. There are, thus, no substantial provable reliance

---

<sup>16</sup> Hereinafter often called agreed damage clauses to avoid the built-in determination of invalidity or validity implied by the words penalty and liquidated damages.

<sup>17</sup> It should be noted that a good deal of authority dealing with executed agreed remedies, e.g., deposits, is a fortiori authority for executory agreed damages clauses. Cases dealing with the former are often cited without distinction from those dealing with the latter. Thus a decision requiring repayment of a deposit would be authority for striking down an executory agreed damages clause in similar circumstances, but the converse is not necessarily true. Cf. 5 Corbin § 1063, at 309. For this reason executory and executed clauses are treated separately herein, although the decisions on these questions are often cited and used interchangeably.

<sup>18</sup> The words "base promise" are used to describe the substantive parts of the contract, i.e., all material agreements and terms of condition, other than the agreed remedy, i.e., penalty clause.

losses to reimburse, and refusal to enforce the penalty does not constitute infringement of the power of contract on the ground of inadequate protection of reliance. Nor, since the law provides sanctions which will deprive the defaulter of any enrichment gained by his breach, is the promisee deprived of the power of contract on this ground.

So, too, with the expectancy created by the promise to pay the penalty. Unless the promise to pay the penalty involves hidden or unprovable reliance, refusal to enforce the penalty will not constitute curtailment of the power of contract. As suggested above, such promises do not seem to involve hidden or unprovable reliance. For example, the expectancy created by the penalty clause is unlike that of the base promise, it has nothing to do with the shifts of market risk, etc. The market economy thus provides no institutional reason for protecting this expectancy. Thus the refusal to enforce the expectancy of payment of a penalty is no infringement of the power of contract.

But if there should be substantial provable or hidden reliance on the "penalty" clause, *i.e.*, the promisee thinks at the time that the deal is made, that the base promise will *not* be performed, then we have alternative base promises, rather than simply an additional sanction for performance of one base promise. If there is such reliance on the alternative promise, we are no longer dealing with a penalty but with alternative contracts,<sup>19</sup> and failure to enforce the alternative promise will result in an infringement of power of contract.

The foregoing discussion leads to the conclusion that if contract is defined in certain purposive terms rather than in traditional systematic terms, the general rule invalidating penalty clauses is not an infringement of the power of contract.<sup>20</sup> The conclusion is, however, a useless abstraction unless the courts (or other lawmakers) are upholding those stipulated remedies clauses where the law does not give sanctions adequate to protect the reliance, restitution and expectancy interests, and

---

<sup>19</sup> 5 Corbin § 1070. In *Campbell Discount Co., v. Bridge*, [1961] 2 Weekly L.R. 596 (C.A.), criticized 24 *Modern L. Rev.* 502, 507 (1961), the court erroneously treated the agreement as an alternative contract, rather than as providing a penalty. And in *Caplan v. Schroeder*, 56 Cal. 2d 515, 364 P.2d 321 (1961) the court treated as an invalid forfeiture what might very well have been given effect as an alternative contract.

<sup>20</sup> If this conclusion is correct, France goes well beyond what is necessary to effectuate power of contract in its law of penalties, since penalties are enforced without much, if any, regard to reliance or expectancy losses or to enrichment of the defaulter. See Schlesinger, *Cases on Comparative Law* 328-31 (2d ed. 1959); Marsh, "Penal Clauses in Contracts: A Comparative Study," 32 *J. Comp. Leg. & Int'l L.*, 66, (1950). There are however specific rules in French law which in many instances effect results consistent with the conclusion in the text. Comment, "Penal Clauses and Liquidated Damages, a Comparative Survey," 33 *Tul. L. Rev.* 180, 183 (1958).

striking them down where it does. With some aberrations this seems to be substantially what the courts are doing.

The problem is to determine what agreed damages the courts enforce and in what situations they refuse to enforce such agreements.<sup>21</sup>

### *Uncertainty of Damages*

It is widely stated and held that for an agreed damages provision to be upheld it must appear at the making of the contract that the harm which would be likely to flow from the breach would be impossible or difficult to estimate.<sup>22</sup> This doctrine has been criticized by Professor

<sup>21</sup> As the perusal of any recent literature on the point indicates, there are some live issues in this question. See, e.g., *Alder v. Moore*, [1961] 2 Weekly L. R. 426 (C.A.); noted in 77 L.Q. Rev. 300, 24 Mod. L. Rev. 637, 3 U. Malaya L. Rev. 287; Dunbar, "Drafting the Liquidated Damage Clause—When and How," 20 Ohio St. L.J. 221 (1959); Smith, "Contractual Controls of Damages in Commercial Transactions," 12 Hastings L.J. 122 (1960); Comments, 9 Stan. L. Rev. 381 (1957), 30 Texas L. Rev. 752 (1952); Note, 1 Adelaide L. Rev. 83 (1960).

One apparent issue is whether the intention of the parties at the time of contracting determines whether a clause is a penalty or liquidated damages. The decisions constantly repeat that their intention governs, although occasionally the contrary view is taken, e.g., *Gorco Constr. Co. v. Stein*, 256 Minn. 476, 481-82, 99 N.W.2d 69, 74 (1959). Both Professor Corbin and Professor Williston have pointed out that such statements cannot be taken literally. 5 Corbin § 1058; 5 Williston (3d ed.) § 788. The Uniform Commercial Code provisions apparently are not founded on the intention notion; Uniform Commercial Code § 2-718(1). The distinction generally makes little difference since whether the parties intended a penalty or intended to liquidate damages is determined by reference to exactly the same circumstances governing whether the clause was a reasonable pre-estimate of damages likely to flow from breach. In two situations, however, it does make a difference. First, a court emphasizing the intention of the parties finds it logically more difficult to deal with cases where the actual damages turn out to be far less than anticipated. The intention of the parties would lead to enforcement of the agreed damages in spite of the change. It is somewhat easier to permit a second look if the question is the reasonableness of the clause because there is no particular reason to look only to reasonableness at the time of the contract. Second, where a clause covers several breaches it may make a difference whether it is the intention of the parties which is looked to or the reasonableness of the provision. See discussion in text below.

<sup>22</sup> Cal. Civ. Code § 1670 (1960):

Every contract by which the amount of damages to be paid, or other compensation to be made, for a breach of an obligation, is determined in anticipation thereof, is to that extent void, except as expressly provided in the next section.

Cal. Civ. Code § 1671 (1960):

The parties to a contract may agree therein upon an amount presumed to be the amount of damage sustained by a breach thereof, when, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damage. Similar provisions are: Mont. Rev. Codes Ann. §§ 13-804, 13-805 (1949); N.D. Rev. Code § 9-0804 (1943); Okla. Stat. Ann. tit. 15, § 215 (1937); S.D. Code, § 10.0704 (1939). See also Ga. Code Ann. §§ 20-1402, 20-1403 (1935). The Uniform Commercial Code § 2-718(1) 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 non-feasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

Restatement, Contracts § 339 (1932):

(1) 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

McCormick, who points out that it is of very limited application in fact, since in most situations damages cannot be foretold with any exactness. Moreover, he suggests that in most cases where the rule is applied "it will usually be found that the amount agreed to be paid was grossly disproportionate to the actual loss, and it is believed that this is the real and only justification for refusing sanction to the agreement."<sup>23</sup> In addition others have criticized the doctrine for having several possible meanings. The doctrine may require

(1) Difficulty of *producing proof* of damages from a breach after it has occurred; (2) Difficulty of determining what damages were caused by the breach; (3) Difficulty of ascertaining what damages were contemplated when the contract was made; (4) Absence of any standardized measure of the damages for a certain breach; (5) Difficulty of forecasting, when the contract is made, all the *possible* damages which may be caused (or occasioned) by any of the possible breaches.<sup>24</sup>

That the doctrine may have numerous meanings does not necessarily make it unsound. Indeed, there may be no objection to saying that the doctrine encompasses all five meanings. In each of the described situations the remedy provided by the law without assistance from the parties may give inadequate protection to the promisee's reliance, restitution, and expectancy interests. In such a case power of contract would be infringed if the parties were not allowed to provide remedies adequate to those purposes. The myriad meanings are therefore not objectionable unless one of them were adopted to the exclusion of the others.

Of more interest to the present discussion is Professor McCormick's objection to the doctrine. He says:

If we reflect that in general the courts enforce promises as parties make them, and that the only reason for departing from that attitude with respect to advance agreements about damages is the danger of oppression from agreements to pay an amount disproportioned to the probable actual damages, it becomes apparent that the ease or difficulty of predicting what damages a judge or jury would give is of small moment. If the agreement reasonably approximates the probable damages which a court would give, why forbid the parties thus to agree, even if the damage could be readily and exactly foreseen?<sup>25</sup>

But the reason for "departing from that attitude" is not simply the danger of oppression.<sup>26</sup> The reason is that the parties are not free to

---

(b) the harm that is caused by the breach is one that is incapable or very difficult of accurate estimation.

See 5 Corbin § 1060; 5 Williston (3d ed.) § 784.

<sup>23</sup> McCormick § 148.

<sup>24</sup> Patterson, Goble & Jones, Cases on Contracts 813 (4th ed. 1957).

<sup>25</sup> McCormick § 148, at 605.

<sup>26</sup> The oft repeated reference to oppression in penalty cases somehow sounds curiously flat, as it does in the whole history of relief against forfeitures and penalties. For

make more strict the legal instrument provided by society. They are not free to change the nature of contract. They may use that almost infinitely flexible tool, but they may not make it more strict. Thus the modern tendency of the law toward favoring liquidated damage clauses in doubtful cases<sup>27</sup> is not at odds with the great increase in legislative and judicial limitation on the power of contract.

Of course, Professor McCormick is far stronger in his further point that there seems to be no sound objection to the parties' relieving the judge or jury of the task of fixing damages even where that task would be an easy one. But this argument, even though it is justifiable criticism of the uncertainty of the damages requisite, does not raise any substantial question of infringement of power of contract.

### *Relation of Amount Fixed to Expected Harm*

It is practically undisputed that the damages provided must not be unreasonably large in relation to the amount of harm which may be expected from the breach.<sup>28</sup> An example of such a case has already been

example, Holdsworth says: "It was obviously against conscience that a person should recover a sum of money wholly in excess of any loss incurred." 5 Holdsworth, *History of the English Law* 293 (3d ed. 1945). Except in equity, however, there has never been any general theory of Anglo-American law that harshness to the defendant or overreaching by the plaintiff prevents the plaintiff from enforcing his contract. But see Uniform Commercial Code § 2-302; 3 Corbin § 559; Bogert, Britton and Hawkland, cases on Sales and Security, p. 9 (4th ed. 1962); Stevens, "A Plea for the Extension of Equitable Principles and Remedies, 41 Cornell L.Q. 351, 366-68 (1956). Why then did the common law choose to give special treatment to the harshness or overreaching which may be present in a so-called penalty? The initial answer may be that the law courts practically had to do so because of the interference of equity. But this only causes the same question to be asked of equity: Why was the Chancellor so insistent upon relief from forfeitures and penalties? It was not simply a case of refusing to perform them specifically because equity restrained the law courts from enforcing them.

One answer to the foregoing questions is that given by Holdsworth:

It was obviously against conscience that a person should recover a sum of money wholly in excess of any loss incurred. A person seeking to do so might in some circumstances come perilously near to committing a fraud, and in other circumstances might be unconscientiously seeking to take advantage of an accident.

5 Holdsworth, *supra*, at 293.

This accounts for individual decisions of equity denying effect to forfeitures and penal bonds, just as equity refused specifically to enforce promises supported by inadequate consideration. But it does not account for the development in equity of a general rule that the recovery on penal bonds was limited to damages actually suffered, except where "the condition was collateral and no recompense or value could be put on the breach of it." 5 Williston (3d ed.) § 775A, at 657.

<sup>27</sup> 5 Williston (3d ed.) § 788. Moreover, often these limitations of contract are to prevent the unwise assumption of risks such as those Professor McCormick describes. McCormick § 147. See also Uniform Commercial Code § 2-302; Notes, 109 U. Pa. L. Rev. 401 (1961), 70 Yale L.J. 453 (1961).

<sup>28</sup> See, e.g., Uniform Commercial Code § 2-718(1); Restatement, Contracts § 339(1)(a) (1932); 5 Corbin § 1059; 5 Williston (3d ed.) § 783; but see *Lama v. Manale*, 218 La. 511, 50 So. 2d 15 (1950), where, pursuant to the Civil Code, the court upheld a clause providing that a tenant would pay five times the daily rent for each day he held over in violation of the lease provisions. Conceivably, the agreed damages might exceed greatly the harm which could be reasonably anticipated at the time of contracting, yet not exceed the harm which actually occurred. I have seen no case involving precisely this point,

discussed,<sup>29</sup> and it was seen that in such a holding there is little or no substantial infringement of the power of contract. The converse implication of this requisite is that where the damages are not unreasonably large in relation to the amount of harm which may be expected, the clause is, unless other doctrine prevents it, enforceable.

### *Relation of Amount Fixed to Actual Harm*

A third requisite of some authorities is a further look before upholding an agreed remedies clause to determine whether it is reasonable "in light of the harm actually caused by the breach."<sup>30</sup> There are several possible approaches to the question of actual losses: (1) Except as evidence helpful in determining what was reasonable at the time of contracting, the amount or existence of the actual loss is irrelevant; (2) the plaintiff does not have to show any loss and need only prove a stipulated damage clause reasonable at the time of the contract; or (3) the plaintiff must prove a stipulated damage clause reasonable at the time of the contract and reasonable in relation to the losses which actually occurred.

#### *(1) Actual damages irrelevant except as evidence of reasonableness*

---

but see the converse, discussed in the text below, where the actual harm turned out to be much less than was reasonably anticipated at the time of contracting.

<sup>29</sup> See text at p. 449 supra.

<sup>30</sup> Of course, even if a court does not purport to follow this rule, in assessing whether the estimated damages were reasonable at the time the contract was made the court will look at what happened subsequently to help judge what the parties had in mind at the time of the making of the contract. 5 Corbin § 1063, at 304-05; McCormick § 150, at 609; contra, Frick Co. v. Rubel Corp., 62 F.2d 765 (2d Cir. 1933) (Learned Hand, J., dissenting).

It is always necessary for the court to recognize the difference between an agreed damage clause and alternative contracts, 5 Corbin § 1070; McCormick § 154; 5 Williston (3d ed.) § 781, especially if the court looks at actual damages. For example, what is worded as a bilateral contract to buy and sell land with an agreed damages clause for breach by buyer may well be intended as an option in the buyer to buy. In such a case, the buyer having had the benefit of his bargain, i.e., the right to purchase for a period of time, it would be most inappropriate not to require him to pay the agreed damages just because the seller later sold the land for more to someone else. The close relation between an option and a bilateral contract to sell land coupled with a deposit by purchaser may be a factor in the reluctance of courts to require return of such deposits even though the seller subsequently sells at a higher price. One common practice where it is not always clear whether the clause is a provision for damages or an alternative contract is an agreement which values certain property or services. See 5 Corbin § 1069. Even though the language used refers to breach, the valuation is often intended to be the price paid if one of the parties elects or is forced by circumstances not to return the property or render the services. See, e.g., Sun Printing & Publishing Ass'n v. Moore, 183 U.S. 642 (1902) (agreed value of ship chartered for service in wartime). This doctrine does not, as may first appear, destroy the rule against enforcing penalties. No matter how worded, it seems unlikely that the court would hold a valuation clause to be in the nature of an alternative contract if the contract provides one valuation for voluntary performance and another valuation to be used if there is no performance.

The courts often use phrases such as "actual damages" very loosely. It thus becomes difficult to determine whether the court means damages actually caused by the breach which occurred, or compensatory damages as opposed to in terrorem penalties. It is, for example, not uncommon to find a court requiring that the amount provided be reasonable in light of actual damages anticipated at the time of the contract. Where it is not possible to have some assurance as to which is meant, the case cannot be cited as authority on the question at hand.

at time of contracting. There are few cases in which the court enforced an executory agreed damage clause where it is reasonably clear that the plaintiff suffered no loss.<sup>31</sup> The courts in many more cases, however, have stated that the actual loss was irrelevant, except perhaps as evidence on the question of reasonableness at the time of contracting. In some such cases the courts excluded proof that there was no harm,<sup>32</sup> in others the statement was only dictum.<sup>33</sup> In a great many cases the loss was one

<sup>31</sup> *McCarthy v. Tally*, 46 Cal. 2d 577, 297 P.2d 981 (1956), criticized in Comment, 9 Stan. L. Rev. 381 (1957); *Parker-Washington Co. v. City of Chicago*, 267 Ill. 136, 107 N.E. 872 (1915) (it is not completely clear that no harm was done by the breach, but the court seems to consider the question irrelevant); compare *Bauer v. Sawyer*, 8 Ill. 2d 351, 359, 134 N.E.2d 329, 333 (1956) where the court quotes apparently with approval, Restatement, Contracts § 339 (1932), which requires "a reasonable forecast of just compensation for the harm that is caused by the breach." There are a few cases, see text below, reaching a result similar to *McCarthy v. Tally*, supra, where a defaulter attempted to recover a deposit.

It may be argued that Uniform Commercial Code § 2-718(1), supra note 21, is in accord with *McCarthy v. Tally*, supra, since it requires reasonableness "in the light of the anticipated or actual harm caused by the breach." But in determining reasonableness the courts are also enjoined to consider "the difficulties of proof of loss, and the inconvenience or non-feasibility of otherwise obtaining an adequate remedy." A clause reasonable in light of anticipated harm would probably be unreasonable under one or both of these latter provisions if there clearly is no loss. Uniform Commercial Code § 2-302 might also be used to strike down the clause in such a case. See generally 1955 Report of the N.Y. Law Revision Comm'n, Study of the Uniform Commercial Code 580, 704.

In *Schutt Realty Co. v. Mallowney*, 215 Minn. 340, 10 N.W.2d 273 (1943), the court allowed recovery of an agreed \$1000 per month for four months delay in performing a building wrecking contract. After it had entered the wrecking contract, the plaintiff-land owner agreed to sell the premises to a third party by a certain date and to pay \$500 a month for delay in doing so. There was a five-month delay because of defendants' breach, and in addition plaintiff spent \$480 completing work defendant should have done, bringing actual damages to \$3380. Thus by the time of breach a situation existed in which it is dubious whether a court would, as an initial proposition, have enforced an agreed damage clause. Nevertheless, for two reasons the case is not a strong one for the proposition that actual damages can be ignored. First, the discrepancy between actual damages and those agreed upon was only about 20% of the former. Second, plaintiff may well have suffered some intangible and unmeasurable damage to its business reputation by its failure to perform the second contract.

For additional cases on this point and those mentioned at notes 32-34, 38, 39, 44 and 76 infra; see Annot., 34 A.L.R. 1336 (1925).

<sup>32</sup> Among such cases are the following: *United States v. Bethlehem Steel Co.*, 205 U.S. 105 (1907); *Frick Co. v. Rubel Corp.*, 62 F.2d 765 (2d Cir. 1933); *Stephens v. Essex County Park Comm'n*, 143 Fed. 844 (3d Cir. 1906); *Wood v. Niagara Falls Paper Co.*, 121 Fed. 818 (2d Cir. 1903); *Matter of Lion Overall Co.*, 55 F. Supp. 789 (S.D.N.Y. 1943), aff'd sub nom. *United States v. Walkof*, 144 F.2d 75 (2d Cir. 1944); *Byron Jackson Co. v. United States*, 35 F. Supp. 665 (S.D. Cal. 1940); *Blackwood v. Liebke*, 87 Ark. 545, 113 S.W. 210 (1908); *Banta v. Stamford Motor Co.*, 89 Conn. 51, 92 Atl. 665 (1914); *Parker-Washington Co. v. City of Chicago*, 267 Ill. 136, 107 N.E. 872 (1915); *Kelso v. Reid*, 145 Pa. 606, 23 Atl. 323 (1892); *Mead v. Anton*, 33 Wash. 2d 741, 207 P.2d 227 (1949). But see *Quail & Co. v. William Kelly Milling Co.*, 184 Ark. 717, 43 S.W.2d 369 (1931). Cf. *Miller v. MacFarlane*, 97 Conn. 299, 116 Atl. 335 (1922) in which buyers of a business who no longer had an interest therein were not permitted to enforce agreed damages clause in penal bond for breach of agreement not to compete. The court indicates that if the buyers were still owners the bond would have been enforceable in full. Compare *Miller v. MacFarlane*, supra, with later Connecticut cases which, without discussing the issue in question, recite the requirements of enforceability without reference to losses actually incurred, *Berger v. Shanahan*, 142 Conn. 726, 118 A.2d 311 (1955); *King Motors, Inc. v. Delfino*, 136 Conn. 496, 72 A.2d 233 (1950). In *Radloff v. Haase*, 196 Ill. 365, 63 N.E. 729 (1902), the court held an agreed damage clause to be a penalty where it was payable upon breach of a covenant not to compete and where the plaintiff had ceased doing business in the area and had moved to another state.

<sup>33</sup> *Priebe & Sons, Inc. v. United States*, 332 U.S. 407 (1947); *United States v. LeRoy*

which, even with full knowledge of the circumstances, could not be measured with any degree of accuracy.<sup>34</sup> Thus on their facts most of these cases hold only that a liquidated damage clause will be given effect (any other requirements being met) if the actual loss sustained is difficult to ascertain or difficult or impossible to prove. Effectuating power of contract requires such a holding, but it does not require holding an agreed damages clause effective if no loss in fact ensued. The offended party in such a case requires no help from the law to protect his reliance or expectancy interests.<sup>35</sup> A case might arise where although there was no loss, the defaulter was enriched by the default. In such a case power of contract calls for the enforcement of an agreed damages clause if the amount of enrichment cannot easily be ascertained or proved in an

---

Dyal Co., 186 F.2d 460 (3d Cir. 1950); Ely v. Wickham, 158 F.2d 233 (10th Cir. 1946); Bailey v. Manufacturers' Lumber Co., 224 Fed. 806 (S.D.N.Y. 1915); Robbins v. Plant, 174 Ark. 639, 297 S.W. 1027 (1927); Downtown Harvard Lunch Club v. Racso, Inc., 201 Misc. 1087, 107 N.Y.S.2d 918 (Sup. Ct. New York County Ct. 1951); Learned v. Holbrook, 87 Ore. 576, 170 Pac. 530, rehearing denied, 87 Ore. 589, 171 Pac. 222 (1918).

<sup>34</sup> See, e.g., United States v. Bethlehem Steel Co., 205 U.S. 105 (1907) (failure to deliver gun carriages on time where the war was nearing its end and "the importance of the time element largely disappeared"); Frick Co. v. Rubel Corp., 62 F.2d 765 (2d Cir. 1933) (delay in accepting delivery of ice machinery, refusal of lower court to allow proof that "cost of delay was infinitesimally small" compared to penalty upheld); Stephens v. Essex County Park Comm'n, 143 Fed. 844 (3d Cir. 1906) (delay in constructing subways, shelters, and lavatories in public parks); Wood v. Niagara Falls Paper Co., 121 Fed. 818 (2d Cir. 1903) (delay in erecting turbines which caused delay in plaintiff's testing or operating its plant); United States v. J. D. Streett, Inc., 151 F. Supp. 499 (E.D. Mo. 1957), modified 256 F.2d 557 (8th Cir. 1958) (breach of warranty that defendant had not employed any person to secure the contract for a contingent fee); Matter of Lion Overall Co., 55 F. Supp. 789 (S.D.N.Y. 1943), *aff'd sub. nom.* United States v. Walkof, 144 F.2d 75 (2d Cir. 1944) (failure to deliver military uniforms to federal government in late 1940); Blackwood v. Liebke, 87 Ark. 545, 113 S.W. 210 (1908) (timber sale, breach of agreement not to leave isolated trees, agreed damages of \$1.00 per tree left standing; market price of trees rose, but no showing whether increase of market price exceeded loss of value because of isolation of remaining trees); Banta v. Stamford Motor Co., 89 Conn. 51, 92 Atl. 665 (1914) (delay in delivering yacht, buyer lost opportunity to take planned trip); Hackenheimer v. Kutzmann, 235 N.Y. 57, 138 N.E. 735 (1923) (breach of covenant not to injure good will, amount of harm obviously small but difficult to ascertain); Kelso v. Reid, 145 Pa. 606, 23 Atl. 323 (1892) (breach of covenant not to compete); Mead v. Anton, 33 Wash. 2d 741, 207 P.2d 227 (1949) (breach of covenant not to compete).

In Callanan Road Improvement Co. v. Colonial Sand & Stone Co., Inc., 190 Misc. 418, 72 N.Y.S.2d 194 (Sup. Ct. Albany County 1947) a market existing at the time of breach did not exist at the time of the contract. How the actual loss could be shown is not made clear, and the court notes that no suggestion had been made that the amount in the clause was "disproportionate."

But see Byron Jackson Co. v. United States, 35 F. Supp. 665 (S.D. Cal. 1940) (delay in delivering pumps to the Soil Conservation Service although the Service was not ready to use them) and Parker-Washington Co. v. City of Chicago, 267 Ill. 136, 107 N.E. 872 (1915) in which there was delay in completing a contract to build a pumping station which was useless until tunnels were built. The contractors building the tunnels were also late. The court was concerned that all the contractors might make the same argument. The decision can therefore be justified on the theory that this \$50 per day delay clause was only this contractor's share of the whole slowdown. A similar result on very similar facts occurred in Manufacturers Cas. Ins. Co. v. Sho-Me Power Corp., 157 F. Supp. 681 (W.D. Mo. 1957).

<sup>35</sup> Professor McCormick takes a contrary view, consistent with his belief that freedom of contract is involved in every refusal to enforce an agreed damages clause. McCormick § 150; but cf. Note, 61 Harv. L. Rev. 113, 130 (1947).

action for restitution. In one other common type of case power of contract would be infringed by refusing to enforce an agreed damages clause. Suppose that such a clause, while reasonable when entered, is excessive in light of the actual loss, nevertheless, the amount of the actual loss is difficult or impossible to prove.<sup>36</sup> In such a case if the plaintiff is allowed to recover only the losses he can prove, he is not receiving the adequate protection he tried to provide for himself, and his power of contract would thereby be infringed. On the other hand, full enforcement alters the nature of the contract instrument by giving him more than full protection of his reliance and expectancy interests. If such a case arose, it would be possible to preserve the nature of contract and still not infringe the plaintiff's power of contract by enforcing the clause partially, allowing recovery of an amount reasonably related to the actual loss and giving the plaintiff all the benefits of doubt as to what the loss was. This problem is closely related to the cases discussed below concerning the relationship of the clause to all possible breaches, including ones which did not occur.

Since effectuating power of contract does not require the strict rule of *McCarthy v. Tally*,<sup>37</sup> that actual losses are irrelevant (except in ascertaining reasonableness at time of contracting), it is not surprising that a number of courts have refused to enforce clauses where the agreed damages were excessive in relation to the actual loss,<sup>38</sup> or have stated

---

<sup>36</sup> *Hackenheimer v. Kurtzmann*, 235 N.Y. 57, 138 N.E. 735 (1923) illustrates the problem. The amount agreed upon was \$50,000, and the breach was interference with the good will of one of the parties. The interference was relatively minor, but not de minimis. This problem is not limited to second-look cases. It can also arise where from the beginning the amount specified is excessive as to any possible loss, yet the exact extent of the damages is difficult to prove, e.g., \$10,000 a week for delay in completion of a small new church building.

<sup>37</sup> 46 Cal. 2d 577, 297 P.2d 981 (1956).

<sup>38</sup> *Rispin v. Midnight Oil Co.*, 291 Fed. 481 (9th Cir. 1923) (demurrer to answer alleging that plaintiff had suffered no damages held improperly granted where complaint alleged agreed damage clause and breach of contract to drill test oil well); *Northwest Fixture Co. v. Kilbourne & Clark Co.*, 128 Fed. 256 (9th Cir. 1904); *Rowe v. Shehyn*, 192 F. Supp. 428 (D.D.C. 1961) (agreement of buyer to pay a deposit in real estate transaction held unenforceable where seller subsequently sold at price above the contract price); *Matter of Gelino's, Inc.*, 43 F.2d 832 (E.D. Ill. 1930); *The Columbia*, 197 Fed. 661 (S.D. Ala.), aff'd sub nom. *Rasmussen v. Home Indus. Iron Works*, 199 Fed. 990 (5th Cir. 1912) (delay in repairing ship; demurrage clause unenforceable where the ship would be idle even if repairs completed on time); *Marshall v. Patzman*, 81 Ariz. 367, 306 P.2d 287 (1957); *Quaile & Co. v. William Kelly Milling Co.*, 184 Ark. 717, 43 S.W.2d 369 (1931); *Miller v. MacFarlane*, 97 Conn. 299, 116 Atl. 335 (1922) (see note 32 supra); *Radloff v. Haase*, 196 Ill. 365, 63 N.E. 729 (1902) (see note 32 supra); *Independent School Dist. v. Dudley*, 195 Iowa 398, 192 N.W. 261 (1923) (breach of contract by school teacher two months before school was to start); *Gorco Constr. Co. v. Stein*, 256 Minn. 476, 99 N.W.2d 69 (1959); *J. I. Case Threshing Mach. Co. v. Fronk*, 105 Minn. 39, 117 N.W. 229 (1908); *Ward v. Haren*, 183 Mo. App. 569, 167 S.W. 1064 (1914); *Fahn v. Dann*, 207 Misc. 834, 140 N.Y.S.2d 787 (Sup. Ct. Onondaga County 1955) (clause providing 50% of contract price as liquidated damages held not enforceable where plaintiff made no allegation of actual damage); *Jones v. Kelley*, 91 S.W.2d 969 (Tex. Civ. App. 1936); *Perkins v. Spencer*, 121 Utah 468, 243 P.2d 446 (1952); *Hathaway*

that enforcement would be denied.<sup>39</sup> Some of these cases reflect a general hostility, less prevalent than it once was,<sup>40</sup> to liquidated damage clauses and on their facts some of these cases give inadequate protection to plaintiff's need to improve on the legal remedy otherwise available to him. Such decisions are an infringement of the plaintiff's power of contract. As explained above, however, the theory upon which the cases proceed is not.

(2) *Plaintiff does not have to show any loss.* The second possible theory is that the agreed damage clause (if otherwise valid) shifts to the defendant the burden of showing that the agreed damages are unreasonable in light of actual losses. Often the defendant will be unable to make any such showing because of the nature of the damages, thus leaving the plaintiff fully protected by the clause. This theory is consistent with the result although not the rationalization of many of the cases refusing to look to the actual damages in determining the validity of the clause.<sup>41</sup> Most of the cases sanctioning the examination of actual damages to determine whether the agreed damages are excessive also are not inconsistent with this theory.<sup>42</sup> In those cases where the defendant is successful in showing a disparity, the plaintiff's power of contract is not necessarily infringed by failure to enforce the clause.<sup>43</sup>

(3) *Plaintiff must prove that the agreed damage clause is reasonable in terms of actual losses.* This doctrine may have been adopted by a

v. Lynn, 75 Wis. 186, 43 N.W. 956 (1889); see cases cited *infra* notes 77-78 allowing recovery of deposits. And see Restatement, Contracts § 339, comment e (1932). Contra, see cases cited *supra* note 32; cf. Parker-Washington Co. v. City of Chicago, 267 Ill. 136, 107 N.E. 872 (1915); Stewart v. Basey, 150 Tex. 666, 245 S.W.2d 484 (1952); Andraesen v. Hansen, 8 Utah 2d 370, 335 P.2d 404 (1959). See also cases cited *supra* note 33.

<sup>39</sup> Langoma Lumber Corp. v. United States, 140 F. Supp. 460 (E.D. Pa. 1955), *aff'd*, 232 F.2d 886 (3d Cir. 1956); Owen v. Christopher, 144 Kan. 765, 771, 62 P.2d 860, 864 (1936) ("if there are no damages suffered, the full amount could not be recovered."); Fidelity & Deposit Co. v. Jones, 256 Ky. 181, 75 S.W.2d 1057 (1934) (subsequent language in the opinion casts some doubt on this dictum); A-Z Servicer, Inc. v. Segall, 334 Mass. 672, 138 N.E.2d 266 (1956); Sonken-Galambra Corp. v. Abels, 185 Okla. 645, 95 P.2d 601 (1939) (in syllabus by court); Collier v. Betterton, 87 Tex. 440, 29 S.W. 467 (1895); but see Stewart v. Basey, 150 Tex. 666, 245 S.W.2d 484 (1952).

<sup>40</sup> 5 Williston (3d ed.) § 788.

<sup>41</sup> See notes 31-34, *supra*. See generally 5 Corbin §§ 1062-63. A large number of cases state that the plaintiff need not plead or prove actual damages in order to recover the full amount of the liquidated damages. See, e.g., United States v. Glens Falls Indem. Co., 152 F. Supp. 840 (S.D.N.Y. 1957); Shipley v. Pittsburg & Lake Erie R.R., 83 F. Supp. 722, 748 (W.D. Pa. 1949); Frank Towers Corp. v. Laviana, 140 Conn. 45, 97 A.2d 567 (1953) (attempt to recover deposit); Smith v. Lane, 236 S.W.2d 214 (Tex. Civ. App. 1951). For a collection of older cases see Annot., 34 A.L.R. 1336 (1925). These statements are not very enlightening out of context since they occur in cases involving a variety of situations. In some situations the existence of actual damages is self-evident, even though in many of these it would be very difficult to prove the amount of those damages; in some the court held the clause to be a penalty on other grounds and in some the court apparently means that even if proved actual damages would be irrelevant.

<sup>42</sup> See notes 38-39, *supra*; but see the cases cited in text in next paragraph below.

<sup>43</sup> For a more complete discussion of this point see pp. 504 et. seq. *supra*.

few courts.<sup>44</sup> Such a requirement in any case where the amount of the actual damage is difficult or impossible to prove destroys the protection the parties sought to give the plaintiff. Yet it is in these very situations that the sanctions of the law are inadequate to protect the plaintiff, and that failure to enforce the agreed damage clause is an infringement of the power of contract. The relatively few cases reaching this result are probably more an expression of an older attitude of hostility toward agreed damage clauses or toward a particular clause than expressions of a considered view of how to handle valid agreed damages clauses in court. Since the trend seems to be toward favoring such clauses<sup>45</sup> and since the results under this theory constitute an infringement of the power of contract, it may be that these few cases (which are not overly clear on the point) are of little use in predicting modern decisions.

#### *Single Amount for Varying Breaches*

A fourth problem of enforceability involves the clause providing for a single sum as agreed damages which would be operable in a variety of types of breaches. Three views have been expressed. Where an agreed damages clause provides the same amount of damages for breaches of varying importance (1) it is unenforceable;<sup>46</sup> (2) it is unenforceable if it would be unenforceable as to any of the breaches to which it applies;<sup>47</sup> (3) it is enforceable if the clause is otherwise enforceable as to the breach which actually occurred.<sup>48</sup>

(1) *Clause unenforceable if applicable to breaches of varying importance.* If applied strictly, this rule would destroy practically all agreed damage clauses. Since it is almost impossible to foresee all the

---

<sup>44</sup> It is not always possible to tell whether the court intended to reach such a result, but in the following cases the court may have done so. In some of the cases the burden of proof probably did not affect the result. *Northwest Fixture Co. v. Kilbourne & Clark Co.*, 128 Fed. 256 (9th Cir. 1904); *Independent School Dist. v. Dudley*, 195 Iowa 398, 192 N.W. 261 (1923); *Goeco Constr. Co. v. Stein*, 256 Minn. 476, 99 N.W.2d 69 (1959); *J. I. Case Threshing Mach. Co. v. Fronk*, 105 Minn. 39, 117 N.W. 229 (1908); *Ward v. Haren*, 183 Mo. App. 569, 167 S.W. 1064 (1914) (plaintiff need only show breach and some substantial damage; then the amount is determined by the clause); *Hathaway v. Lynn*, 75 Wis. 186, 43 N.W. 956 (1889) (apparently the plaintiff has only the burden of showing a "substantial breach" through the showing of some loss by the breach).

In *Caplan v. Schroeder*, 56 Cal. 2d 515, 364 P.2d 321 (1961) recovery of a down payment was sought by a breaching purchaser. The court held that since defendants failed to defend in the trial court on the ground that the clause permitting retention of the payment was an agreement to liquidate damages, the retention could not be upheld on that ground, even though by the standards of prior California cases the clause was enforceable. One cannot help but think that the court was influenced by the subsequent sale by the owners at a price higher than the contract price.

<sup>45</sup> 5 Williston (3d ed.) § 788.

<sup>46</sup> 5 Williston (3d ed.) § 783, at 726.

<sup>47</sup> 5 Corbin § 1066.

<sup>48</sup> *Id.* at 322.

ways in which a given breach can occur and the consequences of every breach, it is also almost impossible to draft a liquidated damage clause which would be reasonable in every conceivable breach.<sup>49</sup> An illustration of this is a lump sum amount for breach of a covenant not to compete for a number of years. Such clauses have been upheld in many cases.<sup>50</sup> Yet a lump sum which is reasonable for a breach throughout most of the period always becomes unreasonable at some stage toward the end of the period.<sup>51</sup> The courts try to avoid this problem with the doctrine by such methods as holding the clause applicable only to substantial breaches.<sup>52</sup> But in many cases where a clause is upheld, it requires little imagination to think of breaches which could have occurred and which would have caused more or less harm to the plaintiff than the one which did occur.

This doctrine is based largely on the intention-of-the-parties theory.

[I]t is impossible to show in such a case that the parties made an honest attempt to estimate the actual injury which would be caused, since no reasonable person would suppose that the injury from any breach which might occur would involve the same damage as any other breach.<sup>53</sup>

The quoted words give a clue as to how the courts limit what would otherwise be an all-destructive doctrine. The less obvious it is that the clause applies to a variety of breaches of varying importance, the more likely it is that the court will enforce the clause in a breach where it otherwise would be enforceable. In these cases it is easiest to find an intention of the parties to pre-estimate actual losses.

It should be pointed out that the parties may act reasonably and with no intention of imposing a penalty even though the same amount does apply to a variety of breaches of varying importance. If the amount is reasonable as to the slightest of these breaches, the agreed damages are doubtless too low for more serious breaches. Thus the intention of the parties as to the serious breaches is to limit liability, not to pre-estimate them, which is not the same as an attempt to assess a penalty.

---

<sup>49</sup> In *Hackenheimer v. Kurtzmann*, 235 N.Y. 57, 138 N.E. 735 (1923), the court limited the broad language of the clause to avoid the "other breaches" doctrine as laid down in *Seidlitz v. Auerbach*, 230 N.Y. 167, 129 N.E. 461 (1920). Judge Andrews said: "*Seidlitz v. Auerbach* may be pressed to so extreme a conclusion as to make it impossible to draw any contract providing for such damages." 235 N.Y. at 67, 138 N.E. at 739.

<sup>50</sup> 5 *Corbin* § 1071.

<sup>51</sup> See *Management, Inc. v. Schassberger*, 39 Wash. 2d 321, 235 P.2d 293 (1951), where the court recognizes this problem. The lump sum in that case was probably unreasonable as to any breach, including the one which actually occurred. But the court's language casts doubt on the validity of any lump sum damage clause in such cases.

<sup>52</sup> See, e.g., *Hathaway v. Lynn*, 75 Wis. 186, 43 N.W. 956 (1889); *Ward v. Haren*, 183 Mo. App. 569, 167 S.W. 1064 (1914).

<sup>53</sup> 5 *Williston* (3d ed.) § 783, at 727. See also *McCormick* § 151, at 611.

There is no general policy of contract law against limiting liability.<sup>54</sup>

In addition to the foregoing criticisms of this doctrine, its operation can be a serious infringement of the power of contract. Quite a few cases have not followed this rule strictly and have allowed recovery under an agreed damages clause applicable to a variety of breaches of varying importance where it was reasonable as to all of them.<sup>55</sup>

(2) *Clause unenforceable if it would be unenforceable as to any of the breaches to which it applies.* In determining to which breaches it applies, this doctrine meets the same problems as the first rule. It too is based on the intention theory, namely that if the parties have specified the same amount of damages for breaches of varying importance, they have not made a genuine effort to pre-estimate actual losses.<sup>56</sup> And in addition it can be said that in one or more of the possible applications the parties have intended to provide for a penalty, to change the nature of the contractual tool supplied by society. For these reasons a large number of courts have refused to enforce agreed damage clauses which were rather obviously applicable to some breaches where the clause would have been unreasonable.<sup>57</sup>

(3) *Clause enforceable if otherwise enforceable as to breach which actually occurred.* The application of either of the foregoing rules constitutes serious infringements of the power of contract whenever the

---

<sup>54</sup> See *Andreasen v. Hansen*, 8 Utah 2d 370, 335 P.2d 404 (1959); 5 Williston (3d ed.), § 781A; 5 Corbin § 1068. This point is discussed extensively in an excellent article, Fritz, "Underliquidated Damages as Limitation of Liability," 33 Texas L. Rev. 196 (1954). But see Uniform Commercial Code § 2-718, comment 1, and § 2-719, comment 1. Of course, underliquidating damages or otherwise limiting liability just as providing for penalties is an alteration of the social tool of contract. There is, however, an important difference. A party is free to contract or not to contract. When he contracts, but limits liability, he is altering the nature of the social tool of contract in the direction of his right not to contract at all. He is thus merely adding flexibility to the tool. In cases where a party is not free to refuse to enter the contract or where society imposes some noncontractual duty, e.g., tort liability, then of course the foregoing point does not apply. Even so, a court may give effect to contracts exculpating a party from noncontractual duties. See, e.g., *Ciafalo v. Tic Tannev Gyms, Inc.*, 10 N.Y.2d 294, 177 N.E.2d 925, 220 N.Y.S.2d 962 (1961); Sutton, "Contractual Exemptions from Liability," 34 Austl. L.J. (pts. 1-2) 290, 311 (1961).

It is doubtless true that limitations on liability are especially prevalent in contracts of adhesion or other unbalanced agreements. But the problems thereby created should not prevent the use of "weak" contracts where the objections of adhesion or unbalance are not present.

Although a party has a right not to contract, he does not have any comparable rights lying on the stricter side of contract. He cannot for breach of agreement lawfully imprison people or take their money or detain their children, etc. His attempt to assess a penalty is an attempt to exercise a power other than the power of contract by pushing contract farther in that direction than society has decided it should go.

<sup>55</sup> See 5 Corbin § 1066, at 322 & n.84 (citing cases).

<sup>56</sup> 5 Corbin § 1066, at 318.

<sup>57</sup> *Ibid.*; McCormick § 151, at 611; 5 Williston (3d ed.) § 783, at 726. In some of the cases the clause was doubtless also unenforceable because it was unreasonable as to the breach which occurred, or, indeed as to any conceivable breach. See, e.g., *Management, Inc. v. Schassberger*, 39 Wash. 2d 321, 235 P.2d 293 (1951).

breach which actually occurred is one for which legal remedies are not fully adequate in protecting the promisee's reliance, restitution, and expectancy interests. It is not surprising, therefore, to find that the doctrine has been criticized by two prominent scholars.

Professor Corbin says:

A case may, indeed, arise in which the amount specified in the contract is a reasonable forecast and estimate of the injury caused by the breach that has actually occurred, even though it would not be so in the case of other breaches that might have occurred. If the contract provision has this actual operation in the case before the court and the extent of injury is difficult of estimation, there is nothing to prevent the enforcement of the express provision.<sup>58</sup>

Professor McCormick is in accord:

In the situation supposed, the defendant has admittedly agreed explicitly to pay the sum sued for in the event of the breach which has occurred, and admittedly the sum sued for is a reasonable one. The defendant should not be given the loophole of escape that, if he had committed a different breach, the sum named would not have been reasonable.<sup>59</sup>

Unfortunately, neither cites any cases to support his position, and I have found little case authority explicitly adopting their viewpoint,<sup>60</sup> but there is a good deal of indirect support for their views. As suggested before, this question lurks and is ignored in almost every case involving an agreed damages clause. Nevertheless, countless decisions enforcing such clauses come down each year. Moreover, the cases refusing to look at actual damages<sup>61</sup> are analogous support, since the courts so holding are in effect denying full concern with the extent of the breach which actually occurred, focusing attention only on the one occurring as anticipated by the parties. If a court refuses to be fully concerned with the breach which in fact occurred, there is little justification for it concerning itself with hypothetical breaches. Further indirect support is to be found in at least one case which involved two agreed damage clauses, one providing for \$40 per acre for harm to growing crops if a levee failed, the other providing \$40 per acre for general violation of a covenant to maintain the levee. The court held the former invalid since

<sup>58</sup> 5 Corbin § 1066, at 322.

<sup>59</sup> McCormick, § 151, at 612.

<sup>60</sup> In *Wise v. United States*, 249 U.S. 361, 364-65 (1919) the court states:

If it were not for the earnestness with which this claim is presented we should content ourselves with the observation that as there was delay in the completion of both buildings, the case falls literally within the terms of the contract of the parties and that a court will refuse to imagine a different state of facts than that before it for the purpose of obtaining a basis for modifying a written agreement. . . ."

At best this is an alternative holding, perhaps only a dictum. A recent English case supports the position of Professors Corbin and McCormick. *Phonographic Equipment (1958) Ltd. v. Muslu*, [1961] Weekly L.R. 1379 (C.A.); 1962 J. Bus. Law 69.

<sup>61</sup> See notes 31-34 *supra*.

damages to extant crops were easily ascertainable, but it enforced the second.<sup>62</sup> It can be argued that such a case is authority for the views expressed by Professors Corbin and McCormick. The law should not turn on whether the parties used one clause to cover different breaches for some of which it was ineffective or whether the parties divided the clause into two clauses, one of which was unenforceable.

The Uniform Commercial Code is in accord with the views of Professors Corbin and McCormick.<sup>63</sup> Although the Code does not mention this problem explicitly, it defines enforceability in terms of reasonableness in "light of the anticipated *or* actual harm caused by the breach," (emphasis added) and other factors not relevant here. There is thus no room in the statutory formula for using the unfortunate "other breach" rule to invalidate otherwise valid agreed damage clauses.

An examination of the law concerning liquidated damages and penalty clauses leads to the conclusion that most of the judicial doctrine and even more of the judicial holdings are consistent with the power of contract as herein defined. That is to say, the courts tend to hold that agreed damage clauses are enforceable when the law does not otherwise give adequate protection to the reliance, restitution and expectancy, interests. And the courts tend to hold that agreed damage clauses are unenforceable penalty clauses when they do more than try to give adequate protection to these interests.

#### PENAL BONDS

Another executory device to fix damages is the penal bond. In spite of their language penal bonds are often devices by which a party to a contract is protected by the credit of a third party against the failure of the other contractor to perform. The amount specified is not an attempt to fix damages, but a limitation on the liability of the third party, and the bond is enforceable only to the amount of damages proven, subject to the limit of the amount specified.<sup>64</sup> Penal bonds, however, are also sometimes used to fix damages for breach or for failure of an event to occur.<sup>65</sup> The latter type raises questions concerning power of contract.

---

<sup>62</sup> *Seid Pak Sing v. Barker*, 197 Cal. 321, 240 Pac. 765 (1925), cited McCormick § 151, at 612.

<sup>63</sup> Uniform Commercial Code § 2-718(1), the text of which appears in n.22, *supra*.

<sup>64</sup> 5 Corbin § 1056, at 268-272. Unlike penalty clauses in contracts, the limitation of liability is effective even though the bond is not a successful attempt to liquidate damages. *Id.* at 276.

<sup>65</sup> A distinction was taken . . . between bonds 'where the party might be put in as good a plight as where the condition itself was literally performed' and cases 'where the condition was collateral and no recompense or value could be put on the breach of it.' In the former case equity would give relief; in the latter case it would not; and this

A common example of penal bonds intended to fix damages are those given to public bodies or officials to secure performance of a statutory duty.<sup>66</sup> The courts enforce these with no showing of pecuniary damages, thus giving them the same effect as a valid agreed damage clause in a contract.<sup>67</sup> It is interesting to note that where such bonds are required, the public body or official could seldom, if ever, show the amount of damage for failure of the conditioned event to occur. Thus, even though these are statutory bonds, the public body in fact receives only the same protection which the effectuation of the power of contract would make available to a private contractor. A few cases have reached the same result where a bond was given to a private person.<sup>68</sup>

When the amount of a penal bond is excessive in relation to anticipated or actual damages, there is no substantial infringement of the power of contract in refusing to enforce it, even though the parties intended it to be enforced, if the law provides sanctions adequate to protect the interests of the obligee of the bond. Just as in the case of other executory agreed damage clauses the courts seem, in the few cases which have arisen, to give effect to such bonds as liquidating damages where the sanctions of the law would otherwise be inadequate.<sup>69</sup> Unlike other executory agreed damage clauses it is difficult to say whether the opposite result would be reached where the sanctions otherwise available are adequate, because most private penal bonds are not treated as attempts to fix damages, in spite of clear language making the face amount of the bond payable unless the condition occurs. This language may be meant literally by the parties, in which case failure to enforce would contravene their intention. Usually, however, there is no way to tell whether or not they meant the language to be taken literally.<sup>70</sup> On the whole the penal bond cases in which the intention of the parties is ascertainable appear not to infringe the power of contract.

---

distinction has developed into the modern distinction between penalties and liquidated damages.

<sup>5</sup> Williston (3d ed.) § 775A, at 657.

<sup>66</sup> 5 Corbin § 1056, at 273; 5 Williston (3d ed.) § 775B, at 661.

<sup>67</sup> In *United States v. Glens Falls Indem. Co.*, 152 F. Supp. 840 (S.D.N.Y. 1957) the court discussed the problem in terms very similar to those it might have used in dealing with any other type of liquidated damage clause.

<sup>68</sup> 5 Corbin § 1056, at 274; McCormick § 147, at 602.

<sup>69</sup> 5 Corbin § 1056, at 274; McCormick § 147, at 602.

<sup>70</sup> But see *Miller v. MacFarlane*, 97 Conn. 299, 116 Atl. 335 (1922) where a penal bond conditioned on defendant's agreement not to compete was held to be intended to be a liquidation of damages. Plaintiff was not allowed to enforce it, because if it were applicable where plaintiff no longer had an interest in the business, it would constitute a penalty.

## FORFEITURES

The prior sections dealt with agreed damage clauses and penal bonds requiring the intervention of the court to be effective. This section deals with agreed remedies clauses where the party attacking the clause is seeking return of something he has given to the party defending the clause. There is a close relation between the two types of clauses and the courts often fail to distinguish them. Any case preventing a forfeiture of an amount paid or value given pursuant to an agreement providing for forfeiture is a fortiori authority for refusing to enforce an executory agreed damages clause in the same circumstances. Refusal to prevent the forfeiture, however, is not necessarily authority for enforcement of an executory clause in the same circumstances. The forfeiture cases involve the conceptual barriers facing plaintiffs-in-default,<sup>71</sup> problems not present in the executory cases.

Forfeitures, just as executory agreed damage clauses, may be intended as alternative contracts.<sup>72</sup> For example, providing for forfeiture of a deposit in a bilateral buy and sell agreement may be intended to give the buyer an option to buy or, in return for having the right to do so for a period of time, to forfeit the deposit. In such a case the fact that the seller sells for a higher price should not give the buyer power to recover his deposit, since that is the cost of his "option." Recovery of the deposit in such a case would infringe the power of contract.

Forfeitures, just as executory agreed damage clauses, may clearly be intended to fix damages. Unlike executory agreed damage clauses, however, forfeiture clauses may, and often do, have another purpose. The provision, the breach of which may lead to a forfeiture, is not solely for measuring damages. The provision may appear to have nothing to do with breach, but rather it may be a part of the working arrangement of the parties. For example, if a service contract provides that payment is to be made at the end of each month, that is part of the arrangement between the parties which in most cases will have nothing to do with a breach. Nevertheless, if the one rendering the service breaches during a month, the situation created by the clause may create a forfeiture, and a court may be asked to prevent it.

A court may be asked to prevent a forfeiture in two basic situations. First, a forfeiture may occur by virtue of operation of the contract where the contract says nothing about it. Second, the parties may

---

<sup>71</sup> See generally authorities collected in Wade, *Cases on Restitution* 472-507 (1958); Dawson & Palmer, *Cases on Restitution* 417-59 (1958).

<sup>72</sup> See, e.g., *Smith v. Chandler*, 199 Ore. 607, 263 P.2d 764 (1953).

expressly agree ahead of time that in the event of breach the forfeiture shall inure to the benefit of the innocent party. The two tend to merge. For example, suppose an employee promises to work for a month and the employer promises to pay him \$1000 at the end of the month. If the employee quits after two weeks, we have a rather clear example of the first situation. And yet if the clause concerning payment is more closely conditioned upon performance it is evident that the parties have come very close to agreeing ahead of time that there would be a forfeiture in event of breach. Nevertheless, they were also arranging the time of payment, a part of the substance of the arrangement itself rather than merely providing for damages upon breach. In such cases, however, the damage aspect is an important one, and the provision is not far different from an express provision for forfeiture.

When the parties do not specify what is to happen if there is a breach by which the innocent party is enriched, effectuation of the power of contract calls for protection of the innocent party's reliance, restitution, and expectancy interests. If the forfeiture exceeds those amounts, requiring the innocent party to return the excess by which he is enriched does not strip him of adequate protection of the interests which we have encompassed in power of contract, even though the provisions as to the forfeiture are quite explicit. Nevertheless, if the innocent party has to return more than the excess, he does not receive that protection, and there is a curtailment of his power of contract. As suggested earlier in another context, this curtailment is perhaps not a very serious one if the innocent party can explicitly provide in the contract for a forfeiture adequate to protect his reliance, restitution, and expectancy interests. But if, where he has so provided, the court prevents the forfeiture in such a way as to leave these interests inadequately protected, then there is a serious curtailment of the power of contract.

This article is not the appropriate place to add to the volume of literature concerning the plaintiff in default. Instead focus will be on those cases where the forfeiture was clearly intended to fix damages. Here it is evident that the parties were thinking of a post-breach situation as well perhaps as the normal fulfillment of the contract.<sup>73</sup>

---

<sup>73</sup> No attempt will be made to carry out the difficult task of ascertaining what the effect is of an explicit forfeiture provision as compared to a forfeiture implicit in the situation created by the terms of the contract. Does an explicit provision help or hinder the one claiming that the forfeiture should not be set aside? See 5 Williston (3d ed.) § 791, at 771-72. As the discussion in the text below indicates, whether the forfeiture is created explicitly or implicitly the same principles should govern, but as has been said: "The significance of a forfeiture clause is difficult to evaluate." Dawson & Palmer, *Cases on Restitution* 430 (1958).

Not surprisingly, the decisions dealing with forfeitures very closely parallel those dealing with executory damage clauses. By and large explicit forfeiture provisions are given effect only where the law does not provide fully adequate protection to the innocent party's reliance, restitution and expectancy interests. However, the reluctance of courts to allow a plaintiff in default to recover sometimes gives an innocent party greater protection when the defaulter is trying to recover from him than where an innocent party is trying to recover from the defaulter under an executory agreed damage clause.<sup>74</sup> This reluctance seems to be the least where the situation in which a forfeiture could occur was most clearly created for the purpose of fixing damages. The reluctance is greatest where the forfeiture occurred simply through performance of the contract with a forfeiture provision superimposed.

One of the clearest examples of a forfeiture provision intended to fix damages is a deposit required as protection against the depositor's default. Often the problem is analyzed by the court just as if it were dealing with an executory agreed damages clause,<sup>75</sup> and applying the same principles.<sup>76</sup>

<sup>74</sup> See especially the installment sales cases, *infra*, notes 81 et seq.

<sup>75</sup> See, e.g., *Barnette v. Sayers*, 289 Fed. 567 (D.C. Cir. 1923). Cf. *Rowe v. Shehyn*, 192 F. Supp. 428 (D.D.C. 1961); *McCann v. City of Albany*, 158 N.Y. 634, 53 N.E. 673 (1899); *Zucht v. Stewart Title Guar. Co.*, 207 S.W.2d 414 (Tex. Civ. App. 1947); *Nelson v. Richardson*, 299 S.W. 304 (Tex. Civ. App. 1927). The Florida courts, however, purport to draw a clear line between the executory clause and deposits, at least in real estate contracts. *Beatty v. Flannery*, 49 So. 2d 81 (Fla. 1950); *Pembroke v. Caudill*, 160 Fla. 948, 37 So. 2d 538 (1948); but see Florida cases cited at note 76 *infra*.

<sup>76</sup> Restatement, Contracts § 340 (1932); *McCormick* § 153; 5 *Williston* (3d ed.) § 790; for a collection of cases see 6 A.L.R.2d 1401 (1949).

Such an agreement will be held to provide a penalty instead of being a liquidation of damages under the same circumstances and for the same reasons as in the case of executory promises to pay a fixed sum of money. A penalty will not be enforced merely because it is in the form of a deposit.

5 *Corbin* § 1074, at 347.

Possible exceptions are the cases dealing with deposits required with bids on public contracts as security that the successful bidder will execute the contract. The courts usually refuse to allow recovery of such deposits. 5 *Corbin* § 1974, at 349. This refusal can be explained as being simply legislative policy, contra to the policy usual in private contracts. *Dunbar*, "Drafting the Liquidated Damage Clause—When and How," 20 *Ohio St. L.J.* 221, 227 (1959). The decisions, however, are not necessarily contra to the policies governing private contracts. As a party to a continual flow of contracts a public body suffers a serious injury, the exact amount of which is unascertainable, if its sealed bidding system is undermined by practices such as withdrawing bids after receipt and opening but before acceptance. See *Gantt*, "Selected Government Contract Problems," 14 *Fed. B.J.* 388, 400-01 (1954). This of course is precisely the type of situation in which reasonable agreed damage clauses are enforced.

Supplementing the cases involving executory clauses cited at notes 30-33 *supra*, the following cases should be noted as holding or stating that actual damages do not determine the validity of the deposit provision; *Broderick Wood Prods. Co. v. United States*, 195 F.2d 433 (10th Cir. 1952); *Barnette v. Sayers*, 289 Fed. 567 (D.D.C. Cir. 1923); *Zucht v. Stewart Title Guar. Co.*, 207 S.W.2d 414 (Tex. Civ. App. 1947); *Nelson v. Richardson*, 299 S.W. 304 (Tex. Civ. App. 1927); cf. *Stewart v. Bases*, 150 Tex. 666, 670, 245 S.W.2d 484, 486 (1952); comment, 30 *Texas L. Rev.* 752 (1952).

In *Seidlitz v. Auerbach*, 230 N.Y. 167, 129 N.E. 461 (1920), a case involving a forfeiture, the court said that "in determining whether the amount of the deposit is to be treated as

Often a contract permits a party to withhold part of the price until completion of the contract and specifies that the withheld portion will not be paid if there is no completion. Such a provision has substantial importance for purposes other than fixing damages. It provides security for the withholder for whatever is due from the other party, and it is an allocation of the costs of credit and working capital. But the provision also fixes damages. A large number of cases have permitted recovery of the balance of the price (less damages) by a de-

---

liquidated damages or as a penalty the agreement is to be interpreted as of its date, not as of its breach." *Id.* at 172, 129 N.E. at 462. The question in the case, however, was whether the clause applied to breaches which would have caused only minor losses and if so whether it was therefore a penalty even though the breach which in fact occurred was substantial. In *J. Weinstein & Sons, Inc. v. City of New York*, 264 App. Div. 398, 35 N.Y.S.2d 530 (1st Dep't 1942), *aff'd*, 289 N.Y. 741, 46 N.E.2d 351 (1942) the appellate division opinion pays a great deal of attention to actual damages, although its language can be interpreted as being concerned only with the intention of the parties at the time of the contract. See also *Fahn v. Dann*, 207 Misc. 834, 140 N.Y.S.2d 787 (Sup. Ct. Onondaga County 1955) (discussed *supra* note 38).

The following cases have held or stated that actual damages were to be considered in determining whether or not the forfeiture could be recovered: *Massman Constr. Co. v. City Council*, 147 F.2d 925 (5th Cir. 1945) (portions of contract price withheld for delay in contract to build bridge; bridge would have been unusable during period of delay because road on other side of river was not completed); *Bedford v. J. Henry Miller, Inc.*, 212 Fed. 368 (4th Cir. 1914) (portion of contract price withheld for delay in performance by subcontractor where prime contractor was subject to same damage clause for delay on prime contract with the government, but government had released prime contractor from liability thereunder); *Marshall v. Patzman*, 81 Ariz. 367, 306 P.2d 237 (1957), *Patzman v. Marshall*, 90 Ariz. 1, 363 P.2d 599 (1961); *Abrams v. St. Louis Library Dist. Bd.*, 364 Mo. 25, 258 S.W.2d 672 (1953); *cf.*, *Plymouth Security v. Johnson*, 335 S.W.2d 142 (Mo. 1960).

In *Beatty v. Flannery*, 49 So. 2d 81 (Fla. 1950) the court distinguished prior Florida cases dealing with executory clauses and refused to allow recovery of a deposit by the breacher of a real estate contract, apparently without consideration of actual damages. In *Paradis v. Second Ave. Used Car Co.*, 61 So. 2d 919 (Fla. 1952) the court in a deposit case put the burden of proving damages on the one holding the deposit, citing *Pembroke v. Caudill*, 160 Fla. 948, 37 So. 2d 538 (1948) which had been distinguished in *Beatty v. Flannery*, *supra*. In *North Beach Invs., Inc. v. Sheikewitz*, 63 So. 2d 498 (Fla. 1953) a case involving a deposit, the court sitting en banc did consider actual damages in an opinion concurred in by three members of the court; two members of the court apparently thought the actual damages irrelevant. In *Haas v. Crisp Realty Co.*, 65 So. 2d 765 (Fla. 1953) the court held that a forfeiture of over \$6000 on a purchase of real estate for \$15,550 was a penalty and refused to affirm a judgment that it was liquidated damages. The court, noting the rule of *Beatty v. Flannery*, *supra*, remanded for a finding whether, under all the circumstances the forfeiture came within the "unjust enrichment" exception thereto and thus shocked the conscience of the chancellor. In *Hyman v. Cohen*, 73 So. 2d 393 (Fla. 1954) the court sitting en banc, two judges dissenting, in upholding forfeiture of a deposit under a lease, discussed the forfeiture clause in the same manner as if it were executory. The court said that the time of the contract determines whether the clause is a penalty, but it went on to say that even though originally an enforceable clause the court might relieve from the forfeiture if it became oppressive. In *Lewis v. Belknap*, 96 So. 2d 212 (Fla. 1957) the court followed *Hyman v. Cohen* distinguishing executory from executed clauses. The latest word from Florida appears to be *O'Neill v. Broadview, Inc.*, 112 So. 2d 280 (Fla. App. 1959) where the court upheld forfeiture of a \$1,500 deposit on a \$10,440 house with an express finding that the amount "is not sufficient to shock the conscience of the chancellor."

The confused picture presented by the Florida courts is directly traceable to a failure to recognize overtly that the policy problems are substantially the same whether the damage clause is executory or executory. Nevertheless the actual results of the Florida cases are largely consistent with a recognition of that similarity.

faulting contractor, although there are some cases to the contrary.<sup>77</sup> One problem often occurring in such cases is that the amount of forfeiture is in inverse proportion to the seriousness of the breach, *i.e.*, the closer the one whose pay is being withheld comes to fully performing, the more that is withheld. Thus even though at the point breach occurs the amount withheld meets all other requisites of an enforceable agreed damages clause, the forfeiture runs afoul of the rule requiring agreed damages clauses to be reasonable as to all breaches to which they are applicable.<sup>78</sup>

With respect to a closely related problem, the security arrangement, the applicable law effectuates power of contract. It is neither necessary nor possible to explore here the details of the rights of redemption of mortgagors.<sup>79</sup> It is clear enough, however, that these rights accomplish the following result: They prevent the parties from agreeing to a security arrangement whereby the creditor upon breach will receive more than the amount necessary to protect his reliance in making the loan and his expectancy of being repaid with interest. The creditor is also able to strip the debtor of any enrichment created by debtor's default. But the rights of redemption prevent the creditor's securing more than this, even though the parties agreed that he could. The power of contract is not infringed since the law gives the creditor fully adequate protection of his contract interests.

The decisions in both the deposit and withholding of price cases and in security arrangements seldom infringe the power of contract as used in this article or do more than uphold the parties' power of contract. Many of the decisions regarding installment contracts, however, go much further than is necessary to uphold the parties' power of contract.

In installment sales of both land and chattels<sup>80</sup> it is very common to provide that title remains in the seller until all installments are paid, and further, that if all the installments are not paid, those already paid shall be forfeited. The provision retaining title in the seller can be fully explained as a security device, but the forfeiture clause can

---

<sup>77</sup> 5 Corbin § 1073; 5 Williston (3d ed.) § 783, at 728; for a collection of cases see 31 A.L.R.2d 8 (1953).

<sup>78</sup> See discussion in text accompanying notes 46-63 *supra*.

<sup>79</sup> For a brief consideration see 3 Williston (rev. ed.) § 771.

<sup>80</sup> The distinction between a deposit and a down payment in an installment sale may sometimes be excruciatingly difficult to determine, as the New York courts, which unfortunately made much turn on the question, discovered. See Corman, "Restitution for Benefits Conferred by Party in Default Under Sales Contract," 34 Texas L. Rev. 582, 594 (1956) and New York cases cited therein. Happily, N.Y. Pers. Prop. Law § 145-a, protecting defaulting buyers of goods who do not take possession, eliminates the importance of the distinction in a great many cases.

only be explained as an attempt to fix damages, superimposed on the situation created by the security arrangement. Despite the very close relation between mortgages and other forfeiture cases and this type of arrangement, a great many decisions have refused to allow the defaulter to recover.<sup>81</sup>

Not all these decisions necessarily overextend the power of contract since in many cases the forfeiture may meet all the requisites of an enforceable agreed damages clause. For example, in retail installment sales the seller retaking the goods upon default probably rarely has any net gain.<sup>82</sup>

In some of the decisions, however, if the court had been dealing with an executory agreed damages clause instead of an attempt to prevent a forfeiture, the clause would probably not have been enforced.<sup>83</sup> These decisions go further than the power of contract requires and permit the parties to make the contract tool more strict than the reliance, restitution, and expectancy interests of the wronged party require. It is not surprising that these decisions have received much criticism<sup>84</sup> and that there is some strong dissent.<sup>85</sup> Since many courts have failed to recognize and to cope with such perversions of contract, extensive legislation attempting to correct the situation has been enacted.<sup>86</sup> To the extent that it is applicable this legislation brings the law governing many installment sales into line with the definition of power of contract suggested herein.

#### SPECIFIC PERFORMANCE

One of the most interesting questions of power of contract concerns the right of a party to a contract to have specific performance. It

<sup>81</sup> 5 Corbin §§ 1074, 1129, 1132, 1133, 1134; McCormick § 153; 5 Williston (3d ed.) § 791.

<sup>82</sup> See Hogan, "A Survey of State Retail Instalment Sales Legislation," 44 Cornell L.Q. 38 (1958). See also McCormick, § 153, at 616. Of course, that the seller buys the goods or land at the foreclosure or other statutory sale for the amount paid in or less, does not necessarily mean he is not enriched. "[P]ublic sale produces only a relatively small portion of the true market value of the auctioned item and is subject to all the economic factors affecting any forced sale." Corman, *supra* note 80, at 601.

<sup>83</sup> See, e.g., *Moore v. Mosher*, 88 Cal. App. 2d 324, 198 P.2d 714 (1948) (\$1300 down payment on purchase of dress shop, total price, \$2300).

<sup>84</sup> See, e.g., 5 Corbin §§ 1074, 1129, 1132-1134; McCormick § 153; 5 Williston (3d ed.) § 791; Corman, *supra* note 80. But cf. Rudolph, "The Installment Land Contract as a Junior Security," 54 Mich. L. Rev. 929 (1956).

<sup>85</sup> See, e.g., *Perkins v. Spencer*, 121 Utah 468, 243 P.2d 446 (1952). Cf. *Plymouth Sec. Co. v. Johnson*, 335 S.W.2d 142 (Mo. 1960); Bodenheimer, "Forfeitures Under Real Estate Installment Contracts in Utah," 3 Utah L. Rev. 30 (1952). See also cases cited 5 Corbin §§ 1074, 1129, 1132-34.

<sup>86</sup> See, e.g., *Paffle v. Sherman*, 368 P.2d 434 (Idaho 1962), Uniform Commercial Code § 2-718; Uniform Conditional Sales Act § 21; N.Y. Pers. Prop. Law § 145-a (layaway sales). For a more complete description of such legislation see Corman, *supra* note 80. See also proposed statutes and studies of the New York Revision Commission 1937. Report of the Law Revision Commission at 343; 1938 *id.* at 47; 1942 *id.* at 181.

could be argued that he has no right at all, since the availability of the remedy is discretionary. This argument accords with some of the definitions of contract which do not specify *what* legal sanctions must be available to constitute a contract.<sup>87</sup> On the other hand, the definition of power of contract suggested herein does not permit this escape:

The power of contract is the availability to a promisee of legal sanctions adequate to protect his reliance on the promise, to prevent gain by default and to effectuate expectancies where there may be hidden or unprovable reliance.

Under this definition the promisee's power of contract includes the availability of specific performance if other remedies are not adequate to protect his interests. Of course, the power may be infringed because of countervailing policies, such as refusal of the courts to use corporal punishment as a means of achieving specific performance. Yet the refusal may still be an infringement. On the other hand, this definition of power of contract leads to the conclusion that, whenever other remedies are adequate to protect the promisee's reliance, restitution, and expectancy interests, there is no curtailment of the power of contract in refusing specific performance. Thus in theory the usual requirement that to secure specific performance legal remedies must be inadequate fits into the above definition of power of contract. It should also be pointed out that the infringement of power of contract, where other remedies are inadequate, becomes far more serious should the court refuse to grant specific performance even though the parties provide that it shall be available.

The question of "agreed specific performance clauses" apparently has arisen in court rarely.<sup>88</sup> One can speculate on the reasons for this paucity, but the most likely one is historical. Since specific performance was an equitable remedy, its prerequisites were jurisdictional.<sup>89</sup> And

---

<sup>87</sup> 1 Williston (3d ed.) § 1, at 1: "A contract is a promise, or set of promises, for breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty." See also Restatement, Contracts § 1 (1932).

<sup>88</sup> Only the following reported cases were found where such a clause or one providing for injunctive relief was or apparently was incorporated in the contract: *Stokes v. Moore*, 262 Ala. 59, 77 So. 2d 331 (1955); *May v. Young*, 125 Conn. 1, 2 A.2d 385 (1938); *Stamatiades v. Merit Music Serv. Inc.*, 210 Md. 597, 124 A.2d 829 (1956) (injunctive relief); *River House Realty Co., Inc. v. Swift*, 31 Misc. 2d 55, 218 N.Y.S.2d 729 (Sup. Ct. N.Y. County 1961) (injunctive relief); *Gamble v. Sukut*, 208 Ore. 480, 302 P.2d 553 (1956) (agreement to be specifically enforceable under the prevailing arbitration law); *Philadelphia Ball Club v. Lajoie*, 202 Pa. 210, 51 Atl. 973 (1902); *Worrie v. Boze*, 191 Va. 916, 62 S.E.2d 876 (1951). For a large number of cases involving co-operative marketing agreements providing for specific enforcement and injunctive relief, see *Evans & Stokdyk, The Law of Co-Operative Marketing* 125 et seq. (1937); *Hanna, Law of Co-operative Marketing Associations*, 229-36 (1931); *Hulbert, Legal Phases of Co-operative Associations* 185-94 (1942); *Packel, Law of Cooperatives* 203 (3d ed. 1956).

<sup>89</sup> Professor Chafee argues persuasively that this is not so, not only in a merged system, but also in an unmerged system. Chafee, *Some Problems of Equity* 301-36 (1950).

one scarcely went around attempting to confer jurisdiction on the Chancellor so blatantly. Consequently, the thought of putting such a provision in a contract would hardly have crossed the common-law mind, but such provisions are probably becoming more common.<sup>90</sup>

The few cases considering the problem support the notion that the courts will treat such clauses as ineffective attempts to confer jurisdiction.<sup>91</sup> Although the clauses are not necessarily useless,<sup>92</sup> the parties

<sup>90</sup> See, e.g., Tannenbaum, "Enforcement of Personal Service Contracts in the Entertainment Industry," 42 Calif. L. Rev. 18 (1954).

<sup>91</sup> In the co-operative marketing contract cases the statute governing marketing co-operatives and their activities commonly provided expressly for specific performance and injunctive relief. In *Oregon Growers' Co-op Ass'n v. Lentz*, 107 Ore. 561, 575, 212 Pac. 811 (1923) both the contract and the statute expressly provided for specific performance. The court said:

The power and jurisdiction of the Circuit Court to hear and determine the question, of whether the defendant has breached his contract and to award equitable relief in a proper case where a breach has occurred, exists independently of this or any other contract.

*Id.* at 575, 212 Pac. at 816. In *Elephant Butte Alfalfa Ass'n v. Rouault*, 33 N.M. 136, 262 Pac. 185 (1926) a similar provision apparently was ignored and the court granted specific performance only after a discussion of the adequacy of the legal remedy and a conclusion that it was inadequate. In *Minnesota Wheat Growers' Co-op Mktg. Ass'n v. Huggins*, 162 Minn. 471, 203 N.W. 420 (1925) the court granted specific performance because of the inadequacy of legal remedies in spite of a liquidated damage clause. It said of a provision similar to that in the *Lentz* case: "Such equitable redress is given, regardless of the provision in the contract. Some authorities hold its incorporation, however, of significant importance." *Id.* at 486, 203 N.W. at 426. The authority cited for the second sentence quoted is not in point. In *Manchester Dairy Sys. v. Haywood*, 82 N.H. 193, 198, 132 Atl. 12, 14-15 (1926), the court said:

Jurisdiction over the subject-matter of a controversy cannot be created or conferred by the agreement of the parties. [citations]. Therefore authority, if any here, is to be found, not in the express stipulations for equitable relief, but in the general principles limiting equitable jurisdiction.

In *Stokes v. Moore*, 262 Ala. 59, 64, 77 So. 2d 331, 335 (1955) the court said:

We do not wish to express the view that an agreement for the issuance of an injunction, if and when a stipulated state of facts arises in the future is binding on the court to that extent. Such an agreement would serve to oust the inherent jurisdiction of the court to determine whether an injunction is appropriate when applied for and to require its issuance even though to do so would be contrary to the opinion of the court.

However, the court later says "[T]he provision for an injunction is important in its influence upon an exercise of the discretionary power of the court to grant a temporary injunction." *Id.* at 64, 77 So. 2d at 335.

In *Stamatiades v. Merit Music Serv., Inc.*, 210 Md. 597, 124 A.2d 829 (1956), however, ambiguous language indicates that the court may have considered the clause to be of some importance:

They got the \$3000 loan, which seems to have been the major objective of their bargaining with Music Service, and as we understand the contract they expressly agreed to an injunction on the basis of having received that very consideration.

*Id.* at 608, 124 A.2d at 834-35.

In *Tobacco Growers' Co-op. Ass'n v. Patterson*, 187 N.C. 252, 121 S.E. 631 (1924) the court seemed to give some weight to the clause, but it also referred to the statutory authorization and emphasized the inadequacy of non-specific relief. In *Lennox v. Texas Farm Bureau Cotton Ass'n*, 16 S.W.2d 413 (Tex. Civ. App. 1929), the dissenting judge expresses concern that under the majority's interpretation of the contract, "the provision in the marketing agreement entitling appellee to the remedy of specific performance might easily become meaningless. . . ." 16 S.W.2d at 423. See also *River House Realty Co., Inc. v. Swift*, 31 Misc. 2d 55, 218 N.Y.S.2d 729 (Sup. Ct. N.Y. County 1961) (provision for injunctive relief). In *Worrie v. Boze*, 191 Va. 916, 62 So. 2d 876 (1951) the court mentions the clause, but does not appear to lean very heavily on it.

<sup>92</sup> For example, especially where there is also an agreed damage clause, a clause pro-

certainly do not have the same power to stipulate effectively for specific performance that they do to stipulate effectively for liquidated damages.

Historical development of equitable remedies obscures the fact that the power of contract calls for the granting of specific performance whenever legal remedies are inadequate to achieve protection of the reliance, restitution and expectancy interests of the promisee. It is true that the equitable test of adequacy of legal remedies, fortuitously or otherwise, tends to cause the decisions to conform to this desideratum, but, when the parties expressly provide for specific performance, power of contract calls for granting that relief when there is *any doubt* of the efficacy of other available remedies.<sup>93</sup> This is not to suggest that equity should specifically and positively enforce personal service contracts<sup>94</sup> or contracts very difficult to supervise.<sup>95</sup> It should be recognized, however, that where specific performance is denied for any such reason or because the legal remedy is not clearly inadequate, the power of contract is infringed, particularly if the parties explicitly provided for such relief.<sup>96</sup>

---

viding for specific performance makes clear that the parties had no intention of allowing the defaulter a choice between performing and paying damages. *Stokes v. Moore*, 262 Ala. 59, 77 So. 2d 331 (1955). Thus if the agreed damage clause is in the form of a deposit, retention may be considered an election barring specific performance; see, e.g., *Close v. Blumenthal*, 11 Utah 2d 51, 354 P.2d 856 (1960); *McMullin v. Shimmin*, 10 Utah 2d 142, 349 P.2d 720 (1960). The court might possibly be less likely to find such election if the right to specific performance were expressly provided for in the instrument.

<sup>93</sup> Professor Corbin hopefully suggests that that day has arrived:

[T]he impression plainly left by the sum-total of reported cases is that the remedy of specific enforcement is as available as other remedies, now that in almost all jurisdictions all remedies are to be sought in a single system of courts and no longer in separate and mutually suspicious courts of common law and courts of chancery. Objections on the ground of inadequacy of money damages are less often made than formerly and are given less consideration by the judges.

<sup>5</sup> Corbin § 1142, at 636.

See also the statement of Mr. Justice Butler in a different context in *Terrace v. Thompson*, 263 U.S. 197, 214 (1923): "[T]he legal remedy must be as complete, practical and efficient as that which equity could afford." The recent survey by Professor Van Hecke reveals a good deal of statutory and case support for the views of Professor Corbin. Van Hecke, "Changing Emphases in Specific Performance," 40 N.C.L. Rev. 1-13 (1961). But see generally, Newman, *Equity and Law: A Comparative Study* 59-67 (1961):

"Adequate" does not mean complete compensation for the wrong. It means merely good enough for the Chancellor to be satisfied that no extreme hardship will result from leaving the plaintiff to his remedy in damages. . . . The use of the word "adequate" should not lead us to believe that it means "best" or even that it means what it says.

*Id.* at 62.

<sup>94</sup> But see *Matter of Staklinski*, 6 N.Y.2d 159, 160 N.E.2d 78, 188 N.Y.S.2d 541 (1959) (motion to confirm an arbitration award granting reinstatement of a manager in charge of production and engineering); Note, 45 *Corn. L.Q.* 580 (1960).

<sup>95</sup> See, however, *Matter of Grayson-Robinson Stores, Inc.*, 8 N.Y.2d 133, 168 N.E.2d 377, 202 N.Y.S.2d 303 (1960), where the court affirmed an arbitration award ordering specific performance of a contract to construct and lease a five million dollar building. See also Note, 109 *U. Pa. L. Rev.* 744 (1961). For discussion of the loosening of traditional reluctance to grant specific performance of extensive and personal service contracts, see Van Hecke, *supra* note 93, at 13-22 (1961).

<sup>96</sup> A court desiring to uphold the power of contract where the parties stipulate for specific performance even though legal remedies are not sufficiently inadequate to meet

## ATTORNEYS' FEES AND OTHER LEGAL EXPENSES

A large gap in the legal protection afforded the reliance, restitution and expectancy interests of the promisee is his inability to recover most of his costs of securing that protection.<sup>97</sup> Since the promisee's gross recovery is the amount necessary to compensate him for his losses (although not necessarily if the measure is restitution), his net recovery of course will not do so. This is not the place to discuss the soundness of the American rule which generally disallows recovery of attorneys' fees and many other legal expenses,<sup>98</sup> but the denial of such fees and expenses in contract cases is an infringement of power of contract. These infringements become more serious if the court refuses to enforce the parties' explicit agreement that a defaulter shall pay reasonable attorneys' fees or other reasonable costs of collecting the claim from him. It is not surprising, therefore, that the courts generally uphold provisions for reasonable attorneys' fees<sup>99</sup> even though such clauses probably most often appear in contracts of adhesion. The requirement of reasonableness effectively precludes the parties from doing more than restoring the adequate protection of the reliance, restitution and expectancy interests which the denial of attorneys' fees would prevent.

## ARBITRATION

Thus far, the types of clauses discussed have been concerned primarily with the substance of contractual relief. Of course, all of them have had procedural aspects; for example, a valid liquidated damage clause eases plaintiff's burden of proof, but these procedural aspects were secondary. One type of provision, however, concerned primarily with the way in which a remedy is sought rather than with the nature of the remedy, is arbitration.

---

traditional equitable tests could find support by analogy to cases involving waiver of the adequacy requirement. See generally McClintock, *Principles of Equity* § 41 (2d ed. 1948); 19 *Am. Jur.*, *Equity* § 26 (1939); 30 *C.J.S.*, *Equity*, § 88 (1942); Note, 11 *Texas L. Rev.* 548 (1933). See Chafee, *Some Problems of Equity* 301-36 (1950) for additional analogous authority.

If effect is given to an agreement providing for equitable relief, the agreement usually automatically operates as a waiver of a jury trial. This fact calls for caution in the application of the position advocated herein, especially in contracts of adhesion, to avoid giving effect to unintentional waivers of such a valuable right. See Chafee, *supra* at 324-32.

The problems in insolvency or bankruptcy created by rights to specific performance would of course arise more often if specific performance became more widely available through agreement. See generally 4 *Collier, Bankruptcy* §§ 60.50 and 70.62 (14th ed. 1942).

<sup>97</sup> But in *Spuches v. Royal View, Inc.*, 13 App. Div. 2d 523, 212 N.Y.S.2d 394 (2d Dep't 1961) the court denying specific performance of a land contract because of conveyance to a third person, allowed recovery of the down payment and (apparently) the attorneys' reasonable legal fees throughout the trial and appeal. See also McCormick § 63.

<sup>98</sup> Professor McCormick concludes that such fees should be allowed. McCormick § 71.

<sup>99</sup> McCormick § 69; for collections of authority see 3 *CCH Condit. Sales-Chat. Mort. Rep.* ¶¶9401-9459; Annot., 17 *A.L.R.2d* 288 (1951).

Refusal to give effect to agreements to arbitrate constitutes an infringement of the power of contract if the law does not otherwise provide sanctions adequate to protect the reliance, restitution, and expectancy interests of the party seeking arbitration. Arbitration may provide sanctions not otherwise adequate to protect those interests. It is argued that arbitration is less expensive than trial, that there is less delay, that the proceedings are less technical, and that the "inexpert jury system" is escaped.<sup>100</sup> Arbitration is often a more satisfactory system for handling alleged breaches if the contractual relations of the parties are of a continuing nature.<sup>101</sup> Arbitration may also make it easier for parties to ensure that the customs of their business govern the result in that an arbitrator knowing the business makes the decision. Thus the pitfalls of an extreme objective interpretation are avoided. Another advantage to the parties is the privacy of arbitration hearings.<sup>102</sup>

While the foregoing arguments cannot necessarily be proved sound in every case, nevertheless, the parties apparently think they are, and it would be difficult to prove them wrong in the face of crowded calendars and not always informed and skillful judges and juries. Thus arbitration clauses arguably give the parties needed protection which the law cannot or does not supply. This being the case, the power of contract is infringed if the courts do not enforce the provisions by whatever means are necessary to make them effective.

It is not intended to suggest that an arbitration provision allowing an arbitrator to alter the nature of contract, for example, by assessing a penalty for a breach,<sup>103</sup> or that a decision of an arbitrator which does

---

<sup>100</sup> 6 Williston (rev. ed.) § 1922, at 5377.

<sup>101</sup> The epitome of this is the collective bargaining agreement.

<sup>102</sup> Gotshal, "Arbitration's Importance to the Lawyer," 1 B.C. Ind. & Com. L. R. 151 (1960). Whether the public interest is served by lending legal sanctions to such secrecy is beyond the scope of this article.

See Mentschikoff, "Commercial Arbitration," 61 Colum. L. Rev. 846 (1961) which refers to individuated arbitration as follows:

Although we do not know, we believe that the chief moving factors here are; (1) a desire for privacy . . . ; (2) the availability of expert deciders; (3) the avoidance of possible legal difficulties with the nature of the transaction itself; and (4) the random acceptance by many businessmen of the idea that arbitration is faster and less expensive than court action.

Id. at 849.

<sup>103</sup> Thus, the court refused to confirm an award granting punitive damages for breach in *Publishers' Ass'n v. Newspaper & Mail Deliverers' Union*, 280 App. Div. 500, 114 N.Y.S.2d 401 (1st Dep't 1952). The punitive damages were in addition to actual damages as found by the arbitrators and were two and one-half times as big. See generally, Note, 109 U. Pa. L. Rev. 744 (1961). But cf. *Matter of Exercycle Corp.*, 9 N.Y.2d 329, 174 N.E.2d 463, 214 N.Y.S.2d 353, (1961); 75 Harv. L. Rev. 835 (1962), 9 U.C.L.A. L. Rev. 214 (1962); 110 U. Pa. L. Rev. 113 (1961). An employee entered into an employment agreement containing an arbitration clause. After the employee worked under the agreement for several years the employer fired him in violation of the agreement to employ him for life. The employee asked to arbitrate, but the employer sought to stay the arbitration on the ground that the contract was lacking in mutuality. The appellate division affirmed the

so, must be enforced to avoid infringing the power of contract. It is not essential to the power of contract to permit the arbitrator to do more than protect the reliance, restitution, and expectancy interests of the wronged party. These interests provide a clue perhaps to where the courts (or the legislature) should draw the line in allowing judicial review of substantive decisions of arbitrators. If the arbitrator has attempted to turn the contract tool into something more binding than the law provides and the award is more than necessary to protect the foregoing interests of the complaining party, then the court should refuse to enforce the award. This is not simply or even primarily because the agreement or award is unfair or harsh, but because society, through the law, does not provide an instrument to accomplish such goals. In short, society will not create a consensual status except within the limits suggested.

In this area courts often infringe the power of contract by their

denial of the motion on the ground that the contract was not lacking in mutuality. 11 App. Div. 2d 677, 201 N.Y.S.2d 885 (1st Dep't 1960). The Court of Appeals affirmed, the majority (four judges) holding that the question of mutuality was for the arbitrators to decide. Two concurring judges (Froessel and Van Voorhis, JJ.) and a dissenting judge (Dye, J.) maintained that the question of mutuality could not be referred to the arbitrators but must be decided by the court, since the very authority of the arbitrators depended upon the existence of a valid contract. The majority view would allow the arbitrators to change the nature of contract rather substantially in that they can apparently enforce a *nudum pactum* if they so desire. It is interesting to note, however, that the decision is not authority for such an alteration of the definition of contract that the definition suggested herein is no longer apt:

A contract is a promise given legal sanction adequate to: (1) protect reliance on the promise by the promisee; (2) prevent gain by default on the promise; and (3) effectuate expectancies created by the promise (a) where there may be hidden reliance or (b) where socially desired reliance may thereby be promoted.

The decision of the majority does postulate the existence of a promise and gives no indication that remedies granted by the arbitrators can do more than accomplish the foregoing purposes. The Court of Appeals has reaffirmed the majority position in *De Laurentis v. Cinematografica de las Americas, S.A.*, 9 N.Y.2d 503, 174 N.E.2d 736, 215 N.Y.S.2d 60 (1961).

In *East India Trading Co. v. Halari*, 305 N.Y. 866, 114 N.E.2d 213 (1953), with no opinion except that of one dissenter, the court affirmed the decision of the lower court enforcing an arbitrator's award, 280 App. Div. 420, 114 N.Y.S.2d 93 (1st Dep't 1952). The contract in question provided for a recovery of the difference between market value and contract price on the day of default and "a penalty, as determined by arbitrators, of not less than 2% and not more than 10% of the market value . . . as of the date of default. . . ." The arbitrators had awarded 2%. This case cannot be cited for the proposition that the court will enforce an arbitrator's award of a penalty because it is not at all clear that the so-called penalty was in excess of the damages which were incurred by the plaintiff. As the majority in the appellate division said:

Judicial notice can be taken of the expense of litigation and the inadequacy of ordinary costs. While we have not adopted a policy of awarding compensatory costs in our court system, there is no reason why in the private forums of trade arbitration a reasonable system of compensatory costs or something of that nature should not be established and recognized. Furthermore, the difference between the contract price and market price may not reflect the full measure of damage and giving the arbitrators some latitude to add to that amount is fair.

*Id.* at 421, 114 N.Y.S.2d at 94.

refusal to grant specific performance of contracts to arbitrate in the future or to stay proceedings brought in violation of the agreement. Since common-law remedies for breach of contract to arbitrate future disputes are generally, although not always, ineffective, these refusals in effect destroy the legal force of such agreements.<sup>104</sup> This situation has been partly remedied in most jurisdictions by statute, and specific performance and stay of proceedings are available for enforcement of agreements complying with the statute.<sup>105</sup> Nevertheless, there are numerous situations in which neither stay of proceedings nor specific performance is available.<sup>106</sup> There does seem to be some tendency, however, in view of legislative changes, to favor such executory clauses even though there is no applicable local statute.<sup>107</sup> The theory of the Nevada court in such a case, *United Ass'n of Journeymen v. Stine*,<sup>108</sup> is that the old hostility to arbitration clauses is a judicial anachronism. While this conclusion may or may not be sound (some notable commentators urge caution in these matters),<sup>109</sup> this is not the place to discuss the merits of various limitations on arbitration. As suggested above, however, agreements to arbitrate disputes, future or present, can nevertheless be judged in terms of the power of contract. As long as the parties are seeking only the procedural advantages of arbitration or substantive advantages which do not change the basic nature of contract, it is an infringement of the power of contract to refuse whatever sanctions are needed to enforce their agreement, and that fact should be considered by the court when making its decision to withhold or grant enforcement. If, on the other hand, the parties or the arbitrator seek to do more than protect the reliance, restitution, and expectancy interests of a wronged party, there is no infringement of the power of contract if the court calls a halt to the effort. The court's decision need not be justified on any policy of preventing harshness or unfairness, the only policy in question being society's decision of what constitutes the contract tool.

---

<sup>104</sup> In many jurisdictions agreements to arbitrate all future disputes are said to be completely void, or it is said that only nominal damages can be recovered for their breach. 6 Corbin § 1433, at 729; 6 Williston (rev. ed.) § 1919. See Restatement, Contracts § 550 (1932). In many situations, however, ways are found to avoid such a doctrine, e.g., by finding the agreement to be one to appraise or value rather than to arbitrate—a nebulous distinction. See 6 Corbin § 1442.

<sup>105</sup> See Sturges, Commercial Arbitrations and Awards §§ 308-59 (1930); 6 Williston (rev. ed.) § 1920; Simpson, "Specific Enforcement of Arbitration Contracts," 83 U. Pa. L. Rev. 160 (1934).

<sup>106</sup> 6 Corbin § 1433; 6 Williston (rev. ed.) § 1919.

<sup>107</sup> See *United Ass'n of Journeymen v. Stine*, 76 Nev. 189, 351 P.2d 965 (1960) and cases cited therein.

<sup>108</sup> *Ibid.*

<sup>109</sup> See, e.g., 6 Corbin § 1433; 6 Williston (rev. ed.) § 1919.

## CONCLUSION

The foregoing subjects of discussion were selected as important illustrations of the relationship between freedom of contract and attempts by parties to a contract to agree ahead of time on the consequences of failure of a party to perform. With the exception of arbitration the various means selected have had to do primarily with what the remedy would be rather than with the way in which it would be secured.<sup>110</sup> The various means by which parties to contracts seek to ease the way in which the remedy can be secured are numerous enough to require an article by themselves.<sup>111</sup> Arbitration was selected as the most important from among these means to illustrate that similar principles apply to these agreements as to those which define the remedy itself.

The decisions of the courts concerning the effect of agreed remedy clauses seem to permit the following generalizations: Where the law can and does supply remedies adequate to protect the promisee's reliance, restitution, and expectancy interests, the courts will not enforce attempts by the parties to provide for additional sanctions. Where the law is inadequate to protect those interests, the courts tend to permit the parties to provide for additional sanctions. The decisions thereby permit us to define contract in terms of sanctions adequate to protect those interests, and freedom of contract as the power to secure those adequate sanctions, but to secure nothing more.

---

<sup>110</sup> The subjects selected by no means exhaust the possibilities. Acceleration clauses in notes for example are "substantive" in this sense, although at the same time nicely illustrating the impossibility of separating completely a remedy from the procedure by which it can be secured.

<sup>111</sup> Among other things a party may attempt: a) to limit jurisdiction to a particular court; see 2 Mont. Rev. Codes Ann. § 13-806 (1949); 1 N.D. Rev. Code §§ 9-0805 (1943); 15 Okla. Stat. Ann. § 216 (1937); 1 S.D. Code § 10.0705 (1939); 6 Corbin § 1445; 6 Williston (rev. ed.) § 1725; Bergman, "Contractual Restrictions On the Forum," 48 Calif. L. Rev. 438 (1960); Note, 45 Cornell L.Q. 364 (1960); cf. Restatement, Contracts § 558 (1932); b) to appoint someone his agent for receipt of service of process in connection with any matter arising out of the contract; (c) to permit another party to confess judgment on his behalf; 6 Williston (rev. ed.) § 1724; for a collection of state law see 3 CCH Condit. Sale-Chat. Mort. Rep. ¶¶ 9401-9459; (d) to waive the statute of limitations or to provide that the period for bringing suit shall be shorter than that provided by the applicable statute of limitations; Uniform Commercial Code § 2-725; Montana, North Dakota, Oklahoma and South Dakota statutes cited supra; 2, 3 N.D. Rev. Code §§ 26-1310, 36-2005 (1943); 1 Corbin § 218; 6 Williston (rev. ed.) § 1722; Note, 23 Cornell L.Q. 607 (1938); Bogert, Britton, and Hawkland, Cases on Sales and Security p. 628 (4th ed. 1962) (e) to waive jury trial; see, e.g., Federal Housecraft, Inc. v. Faria, 28 Misc. 2d 155, 216 N.Y.S.2d 113 (2d Dep't 1961); 6 Williston (rev. ed.) § 1722; (f) to alter rules of evidence which would otherwise obtain, 1 Wigmore Evidence § 7a (3d ed. 1940); 6 Williston (rev. ed.) § 1723. See generally Uniform Commercial § 2-719, and comments thereto; Bunn, "Freedom of Contract under the Uniform Commercial Code," 2 B.C. Ind. & Comm. L.R. 59 (1960); Isaacs, "Contractual Control Over Adjective Law: Recent Developments," 83 U. Pa. L. Rev. 177 (1934).