Indiana Law Journal

Volume 11 | Issue 3 | Article 13

2-1936

Damages-Liquidated Damages-Penalty

DAMAGES—LIQUIDATED DAMAGES—PENALTY.—Plaintiff sued defendant to recover liquidated damages for defendant buyer's breach of a contract to purchase certain brands of flour manufactured by plaintiff seller. The contract provided for liquidated damages in case of buyer's failure to furnish shipping instructions, on the basis of ⅓ cent per day per barrel of flour from date of sale to date of termination as expense of carrying, plus twenty cents per barrel as cost of selling, plus or minus the amount or the difference between the market value at date of sale and the market value at date of termination of the amount of wheat necessary to manufacture the number of barrels of flour undelivered. Defendant contends that the contract provision for liquidated damages is invalid as the measure of damages in Indiana for breach of contract for sale of goods is the difference between the contract price and the market price at the date of breach. Held, the contract provisions for liquidated damages were valid and the damages assessed were not excessive.[1]

Damages, as that term is used in the law of contracts, is intended compensation for a breach, measured in the terms of the contract. Damages are awarded by a jury, by the court in applying the rules of damages, or by the parties to a contract when they liquidate the damages by attempting in advance to estimate in good faith the actual damage which will probably flow from the breach.

Liquidated damages have not been permitted by the courts when they had the characteristics of a penalty rather than a bona-fide attempt by the parties to estimate their probable injury. As a general rule the intent of the parties is controlling as to whether a provision is for liquidated damages or is a penalty,[2] but the courts are not bound by the name given to the agreement by the parties in determining the character of the sum payable on

---

24 (1911), 176 Ind. 234, 247, 94 N. E. 819, 824.
25 26 Journal of Criminal Law and Criminology, 289.
1 Letellier et al. v. Abilene Flour Mills Co. (1935), 198 N. E. 111.
2 United States v. Bethlehem Steel Corp. (1907), 205 U. S. 105.

default.[3] The agreement will be construed with respect to the circumstances surrounding the contract, the ease or difficulty of measuring the damages, and whether the sum named is out of proportion to the actual damages resulting from the breach.[4] "The question must be determined in a great measure from the facts as they arise in each particular case," the court stated in the instant case, and it quoted from Dowd v. Andrews[5] that "when the nature of the contract is such that upon a breach thereof the resulting damages will be uncertain and difficult of proof, and the amount of damages fixed by the parties is not greatly disproportionate to the loss likely to be occasioned by the breach, the same will be treated as liquidated damages."

When the court, by properly construing the agreement so as to determine the intent of the parties as to what result it was intended to accomplish, finds that the provision provided for liquidated damages rather than a penalty, such provision will be recognized as valid and enforced, according to the weight and trend of modern authority.[6] Indiana recognizes the validity of contracts providing for liquidated damages, stating in Mondamin Dairy Co. v. Brudi[7] that "The rule generally affirmed by the authorities is that, where it is agreed by the parties that the sum or rate fixed in a contract shall be liquidated damages, and the case is one in which they are at liberty to so agree, such an agreement must stand and control, unless it is inconsistent with other parts of the contract, or is unreasonable or unconscionable, in view of the probable damages which may flow from a breach of said contract."

At one time the courts almost universally construed liquidated damages provisions in contracts as penalties and would seldom admit that such clauses were valid. The modern tendency, however, is to construe these provisions liberally and allow the parties to make their own contracts so long as they stay within the bounds of reasonableness.[9] The courts have taken the position that where damages are not readily ascertainable or susceptible of proof it is highly equitable for the parties to determine as nearly as possible the amount which will compensate the injured party.

Two reasons have been advanced for this change of position. One is that as business men are constantly striving towards certainty and security of position they should be permitted to make definite provisions in their contracts as to what results will follow if a breach occurs. If this privilege is denied, it is reasoned, many contracts would be made and enforced which would not have been entered into by the parties in the absence of such certainty of position

[3] Weiss v. U. S. Fidelity & Guaranty (1921), 300 Ill. 11, 132 N. E. 749; Dowd v. Andrews (1922), 77 Ind. App. 627, 134 N. E. 294, Davis v. Freeman (1862), 10 Mich. 188, Greenblatt v. McCall & Co. (1914), 67 Ala. 165, 64 So. 748.

[4] In re McGreary (1884), 31 Pitts. Leg. Jrnl. (Pa.), 317, J. I. Case Threshing Machine Co. v. Fronk (1908), 105 Minn. 39, 117 N. W 229.

[5] (1922), 77 Ind. App. 627, 134 N. E. 294.

[6] Sun Printing & Publishing Assn. v. Moore (1902), 183 U. S. 642; U. S. v. United Engineering & Contracting Co. (1914), 234 U. S. 236, Wise v. U. S. (1919), 249 U. S. 361.

[7] (1904), 165 Ind. 642, 72 N. E. 643.

[8] Tayloe v. Sandiford (1822), 7 Wheat. 13, Davis v. Gillett (1872), 52 N. H. 126, Wallis v. Carpenter (1866), 95 Mass. 19; 53 L. R. A. 122; Sedgwick on Damages, 9th ed., sec. 392.

[9] U. S. v. Bethlehem Steel Corp. (1907), 205 U. S. 105, Quaile v. Kelley Milling Co. (1931), 184 Ark. 717, 47 S. W (2nd) 369.

as is afforded by a provision for liquidated damages. "In the complexities of modern business, breaches of contract involve more incidental but real damages than when business was less complicated. In later years business men have been more desirous of contracting as to damages in order that their liability may be a known rather than an unknown quantity."[10] The modern industrial machine with its large plant overhead and mass production equipment, geared to a specific demand, is a delicate organism and its workings are easily upset. The courts apparently now seek to protect it against the dangers of uncertainty by allowing its managers to hedge their position with contract provisions. There has been no indication, however, that the courts intend to allow a contracting party to take advantage of this tendency towards liberality of construction and permit enforcement of unfair or unreasonable provisions for liquidated damages.[11] Such provisions continue to be regarded with disfavor by the courts.

The other reason advanced for the shift of attitude is that the courts are encouraging the tendency away from litigation, which tendency benefits both the courts in relieving them from crowded calendars, and the parties to the agreement in relieving them of the expenses and delay necessarily incident to law suits. The Supreme Court of Wisconsin illustrated the modern tendency by its statement in Sheffield-King Milling Co. v. Jacobs[12] that "The removal of managers from the business of a large, highly organized concern during the time necessarily consumed in a trial entails an expense, in excess of recoverable costs, so great as to prevent in many cases any reimbursement to a manufacturer. Modern business is so managed as to avoid litigation—a tendency which should be encouraged in all fair and legitimate ways because it is conducive to the general welfare."

The instant case indicates that the Indiana courts are following the modern tendency to construe these provisions liberally. The liquidated damages provisions of the contract under consideration differed from the established rules of damages used by the courts in that: (1) the damages were not measured in terms of the price of flour, the subject matter of the contract, but by the price of wheat, the raw material from which this commodity was made; (2) the amount of damages was determined by finding the difference between the price of wheat on the date of the contract and its price on the date of breach, the usual rule of determining the damages by finding the difference at the date of breach between the market price at place of delivery and the contract price being waived by the court in favor of the contract provisions.

M. E. W

CONTRACTS—OFFER AND ACCEPTANCE—LAPSE OF OFFER.—By the case as reported, defendant sponsored and conducted a racing stake for horses. Entries were to be permitted according to rules contained in a printed nomination blank used for that purpose. Among the entrance requirements necessary was one providing that entry fees were to be paid by May 1. Plaintiff was the owner of two horses and wishing to enter them sent in the amount required

[10] Quaile v. Kelley Milling Co., supra.
[11] Kothe, Trustee, v. R. C. Taylor Trust (1930), 280 U. S. 224.
[12] (1920), 170 Wis. 389, 175 N. W 796.