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Liquidated Damages as Prima Facie Evidence

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Liquidated Damages as Prima Facie Evidence

Parties to a contract often agree on the damages to be paid in the event of breach. These damages are said to be "liquidated" in the contract itself. However, the recovery provided may not equal the actual loss, the amount which would be recovered under the standard measure of contract damages. Indeed, a liquidated damages clause may provide recovery of an amount greater than the actual loss, thereby placing the plaintiff in a better position than he would have been in had the defendant performed. Under such circumstances, enforcement of the liquidated damages clause would conflict with the standard measure of contract damages.¹

The standard measure of contract damages implements a policy of compensation. As Mr. Justice Holmes observed:

The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it,—and nothing else.²

One classic work³ explains that "it is impossible to separate the law of contract damages from the larger body of motives and policies which constitutes the general law of contracts."⁴ It must be remembered


It is necessary to remember that the grant of state power to a contracting party to enforce his bargain is not self-justifying. Cf., e.g., Llewellyn, What Price Contract?—An Essay in Perspective, 40 YALE L.J. 704, 718-22 (1931); Farnsworth, The Past of Promise: An Historical Introduction to Contract, 69 COLUM. L. REV. 576 (1969). Therefore, any study of contract damages should begin with the premises upon which contract law is founded.
that contract law structures exchange relations in the competitive market and enforces individual contracts in order to encourage efficient utilization of resources in this market. Therefore, the compensation for breach should be consistent with the allocation provided by the competitive market. Damages computed under the standard contract measure effectuate a policy of compensation consistently with the allocation of the competitive market, but enforcement of a liquidated damages clause which provides recovery of an amount greater than the actual loss does not.

Some commentators, however, have suggested that a liquidated damages clause should be enforced without regard to the actual loss. Indeed, courts have advanced several arguments for enforcing liquidated damages clauses which award damages greater than the actual loss. This note will examine the arguments for strict enforcement of these agreements, together with the underlying assumptions of the courts in approaching a liquidated damages clause, by applying a model of the market system. This note will suggest that a liquidated damages clause should be considered prima facie evidence of damage, enforceable unless it is proven that actual loss is less. This solution would resolve ambiguities in the law, give force to the agreement of the parties, and allow the parties to provide a remedy when proof of actual loss is impossible.

**The Model of Perfect Competition**

In order to facilitate a clear understanding of the impact of liquidated damages on the competitive market's maintenance of the efficient utilization of resources, a model of a perfectly competitive market will be used. This model has the following characteristics:

1. firms produce a homogeneous commodity, and consumers are identical from the seller's point of view, in that there are no advantages or disadvantages associated with selling to a particular consumer;
2. both firms and consumers are numerous, and the sales or purchases of each individual unit are small in relation to the aggregate volume of transactions;

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(3) both firms and consumers possess perfect information about the prevailing price and current bids, and they take advantage of every opportunity to increase profits and utility respectively; (4) entry and exit from the market is free for both firms and consumers. 

To the extent that the law approximates this model, there will be efficient utilization of resources and the market will be in equilibrim. When an economic inefficiency occurs, the market is in disequilibrim, in the face of which the perfectly competitive market corrects itself.

The ability of a producer or consumer to enter or leave a market is an important corrective for market disequilibrim. For instance, where there is an oversupply, market mobility permits firms to transfer their productive capacity to another market easing the oversupply and restoring equilibrim. If the competitive market is to allocate resources efficiently, market mobility must not be discouraged. In order to encourage efficient exchange relations in the competitive market, the law must respond to a breach of contract in a manner which will allow market mobility.

When the amount provided in a liquidated damages clause exceeds actual loss, enforcement of the liquidated damages clause imposes a price for breach which is higher than the cost of compensating the innocent party, thus deterring breach of inefficient contracts and denying mobility in the market. Clearly, when a party breaches a contract which has become unprofitable, overcompensation such as this is not the proper remedy.

To penalize [market] adjustments through overcompensation of the innocent party is to discourage efficient reallocation of community

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9 Since this model excludes many variables, it will not permit analysis of every transaction. However, it may provide a basis for a consistent theory of contract damages. Cf. F. Knight, Risk, Uncertainty and Profit 76 (1921):
In order to study first the most essential features of exchange relations, it will be necessary to simplify the situation as far as possible by a process of "heroic" abstraction.
10 When there is efficient utilization of resources, the market is said to be in equilibrim: the quantities of goods produced are equal to the quantities of goods demanded. No goods are produced which are not "needed." See C. Ferguson, Microeconomic Theory 210–22 (1966); C. Ferguson & S. Maurice, Economic Analysis 175–79 (1970); A. Alchian & W. Allen, Exchange and Production: Theory in Use 85–87, 337 (1969).
12 Birmingham, Breach of Contract, Damage Measures, and Economic Efficiency, 24 Rutgers L. Rev. 273, 284 (1970). Professor Birmingham points out that fear that the plaintiff will be undercompensated does not justify punishment of the party who has breached the contract. Rather, the general rule of recovery must be more efficiently implemented. For example, the breaching party should bear the transaction costs of his breach as part of the price for breach. Id. at 285.
resources. . . . Rigidity resulting from thus binding a party to his undertaking limits the factor and product mobility essential to proper functioning of the market mechanism.\textsuperscript{13}

Instead, the competitive market requires that no higher price for breach be imposed than the cost of compensating the victim.\textsuperscript{14} Where contracts have become unproductive, breach of contract should be encouraged by awarding only compensation, because compensation properly reallocates resources. With this analytical framework in mind, the arguments for strict enforcement of liquidated damages will be discussed.

**LIQUIDATED DAMAGES AS AN EXCEPTION TO COMPENSATION**

Three arguments have been advanced for treating liquidated damages as an exception to the ordinary policy of compensation. First, it has been argued that if it was the parties' "intent" to make a reasonable estimate of possible future damages, then that estimate should be binding on the court without regard to actual loss.\textsuperscript{15} Second, it has

\textsuperscript{13}Id. at 284–85. Professor Birmingham illustrates this by drawing upon the common law labor contract. When the employer breached such an agreement, the employee was under a duty to mitigate his losses by finding other employment. This served economic efficiency because:

If the value of a worker hired at a salary of $10,000 falls to $8000, an employer will gain through repudiation of their agreement when the resulting cost to him is less than $2000. If transaction costs are disregarded, breach will thus be profitable to the employer if and only if the worker can obtain another job paying more than $8000. A new employer will not normally pay the worker more than what he anticipates his services will contribute to the undertaking. The rule therefore encourages breach where the product of the worker would be greater in an alternative position and discourages breach where the product would be less.

\textsuperscript{14}Cf. Holmes, *The Path of the Law*, 10 Harv. L. Rev. 457, 462 (1896): No where is the confusion between legal and moral ideas more manifest than in the law of contract. . . . If you commit a tort you are liable to pay a compensatory sum. If you commit a contract, you are liable to pay a compensatory sum unless the promised event comes to pass, and that is all the difference. But such a mode of looking at the matter stinks in the nostrils of those who think it advantageous to get as much ethics into the law as they can. Holmes would also guarantee every man's right "to break his contract if he chooses. . . ."

\textsuperscript{15}See note 19 infra & text accompanying.
been urged that liquidated damages should be enforceable as a bet.\(^\text{16}\) Finally, commentators have suggested that the strict enforcement of a liquidated damages clause would promote judicial economy and efficiency by displacing time-consuming litigation.\(^\text{17}\)

**Liquidated Damages and the "Intention" of the Parties**

Generally, courts will not automatically enforce a liquidated damages clause.\(^\text{18}\) However, some courts have indicated that if it was a reasonable estimate of the damages they would award the liquidated damages without regard to actual loss.\(^\text{19}\) Similarly, other courts have said that if the amount of damages was uncertain at the time of contract, the courts are also authorized to strike down liquidated damages clauses by both the **Uniform Commercial Code** and the **Restatement of Contracts**.

**Uniform Commercial Code § 2-718(1):**

Damas for breach by either party may be liquidated but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

**Restatement of Contracts § 339(1) (1932):**

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:

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

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

\(^{16}\) See notes 26 & 27 *infra* & text accompanying.

\(^{17}\) See note 32 *infra* & text accompanying.


Professor Williston records that the early form of contractual obligation was a bond upon condition, a security device to compel performance. The bond itself was a promise to pay a sum certain unless the condition was performed. Certainly by the time of the Restoration, equity granted relief against certain of these bonds. Equity would relieve against "penalty" bonds, but not against those where no value could be placed upon breach. That distinction has developed into the present distinction between penalties and liquidated damages. S. Williston, A TREATISE ON THE LAW OF CONTRACTS §§ 774-75A (3d ed. W. Jaeger 1968).

The courts are also authorized to strike down liquidated damages clauses by both the Uniform Commercial Code and the Restatement of Contracts.
although capable of proof at the time of trial, the liquidated damages clause would still be enforceable. In effect, these courts would bind the parties to their original agreement if their "intention" at the time of contract was to make a reasonable, present estimate of a possible, future loss.

This position assumes that the parties, at the time of contract, fashioned a remedy consistent with the market allocation. If the remedy is in fact consistent, the liquidated amount will equal the actual loss and enforcement would provide compensation. However, the position of the parties relative to the market may have changed by the time breach occurs. Hence, the amount of actual loss may be less than the amount computed under the liquidated damages clause. Precisely because market position has changed, it may be desirable to encourage breach in order that the market may regain equilibrim. If the law is unable to rectify deviation from the efficient allocation of resources, it perpetuates inefficiency. In order that the market may restore equilibrim, only compensation for actual loss should be awarded by the court, whatever may have been the intention of the parties.

**Liquidated Damages as a Bet**

One commentator has argued that a liquidated damages clause should be treated as a secondary promise to pay money, enforceable in its own right independently of any losses caused by breach of the "primary" promises in a contract. Damages for breach of the promise

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21 To a great extent, cases which have announced this position seem to have overstated the issue before them. The determination of whether the estimate made by the parties was "reasonable" often turns upon evidence bearing upon the extent of actual loss. See note 55 infra & text accompanying.

22 Cf. text accompanying note 14 supra.


24 Barton, *The Economic Basis of Damages for Breach of Contract*, 1 J. LEG. STUD. 277, 283–87 (1972). Professor Barton relies upon Birmingham, *Breach of Contract, Damage Measures and Economic Efficiency*, 24 RUTGERS L. REV. 273 (1970). However, Professor Birmingham's work demonstrates that the common law rules of contract damages serve economic efficiency by preventing overcompensation. Id. at 284 et seq. This note argues that under Professor Birmingham's analysis, economic efficiency would not be served if liquidated damages were strictly enforced. See text accompanying note 12 supra.
to pay the liquidated amount would, of course, be equal to the liquidated amount. Such a promise, it is said, should be enforceable as a bet.

The most obvious objection to such an approach is doctrinal: that a bet is void as against public policy and unenforceable at common law. Yet even assuming no public policy against bets, a bet in the form of a liquidated damages clause would still face serious objections to its enforcement.

A liquidated damages clause which provides for a recovery greater than the actual loss would operate to penalize a breach of the primary promises in the contract. Such a penalty discourages market mobility and is economically inefficient, and is thus inconsistent with the operation of a competitive market which the policies underlying contract law facilitate. Therefore, even if bets were generally enforceable, a bet of this sort should not be.

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25 If found to be enforceable, a liquidated damages clause is simply an agreement to pay a sum of money. For breach of such an agreement, the victim may usually recover the face amount with legal interest thereon. 5 A. CORBIN, CORBIN ON CONTRACTS § 1078 (1964).

26 Barton, The Economic Basis of Damages for Breach of Contract, 1 J. LEO. STUD. 277, 283–87 (1972). Professor Barton limits the application of this rule to cases where the contract negotiations were “fair.” By “fair,” he means negotiations between parties “with a rather complete knowledge of each other's utilities.” Id. at 282–83. His analysis thereby excludes any problems raised by bargaining that is oppressive due to a lack of information. This note will also exclude analysis of adhesion or unconscionability and will assume fair bargaining. The solution proposed in this note is made expressly inapplicable where the bargain is unfair. See note 39 infra.

27 See 7 A. CORBIN, CORBIN ON CONTRACTS § 1484 (1964). Where a liquidated damages clause exceeds actual loss, more than simply the risk of breach has been allocated. In fact, a new risk has been created: the risk that one party must pay an amount in excess of compensation for breach of the primary promise in the contract. The creation of such a risk is the creation of a bet. Id.

In order to avoid the imputation of a bet, it might be argued that a liquidated damages clause is insurance. The analogy in insurance would perhaps be the “valued policy” in which the parties make a pre-estimate of the value of the thing insured. In the absence of fraud, such a policy is generally enforceable. See W.R. VANCE, HANDBOOK ON THE LAW OF INSURANCE § 157 (1951). However, where loss is not total, the face amount of a valued policy is not recoverable. Rather, only the amount of actual loss may be recovered. J.A. APPLEMANN & J. APPLEMANN, INSURANCE LAW AND PRACTICE § 3861 (1972). Accordingly, if liquidated damages are analogized to valued policies, they could not be awarded in their face amount were it shown that plaintiff did not suffer the full extent of the damages anticipated and provided for in the liquidated damages clause. Any recovery beyond actual loss would be the payment of insurance where there was no insurable interest. See 7 A. CORBIN, CORBIN ON CONTRACTS §§ 1481–82 (1964).

Professor Barton, apparently conceding that liquidated damages clauses are not insurance, calls for their enforcement as bets. Barton, The Economic Basis of Damages for Breach of Contract, 1 J. LEO. STUD. 277, 287 (1972).

28 See text accompanying note 12 supra.

29 See text accompanying note 9 supra.

30 The enforcement of a bet represents merely a wealth transfer, and economic policy would be indifferent to a choice between enforcement and non-enforcement since it would be impossible to determine which of two individuals, as individuals, would derive greater benefit from the goods in question. See J. HENDERSON & R. QUANDT, MICROECONOMIC
Ironically, although the suggestion that liquidated damage clauses should be enforced as a bet is offered as a means of encouraging parties to allocate the risks of breach through this device, strict enforcement of such clauses would deter their use for this purpose. Presumably, when parties bargain over a liquidated damages clause, they discount the value of the agreement by the risk that it will be unenforceable. This discount is reflected in the lower "premium" which must be paid in order to obtain a liquidated damage clause. However, if these agreements were strictly enforced, they would be more valuable and the premium necessary to obtain one would increase. This higher premium would discourage the purchase of such agreements, even in those situations where they are efficient, for example, when it would be desirable to allocate damages which could be peculiarly difficult of proof. Since strict enforcement would deter liquidated damages even when they serve economic efficiency, such a policy is counterproductive.\(^3\)

**Judicial Economy**

Finally, the argument has been made that considerations of judicial economy justify the enforcement of all liquidated damage clauses.\(^2\) Clearly, such strict enforcement would eliminate costly litigation by making proof of damages unnecessary. An absolute rule of this kind would also encourage settlements since the outcome of litigation could be easily predicted. However, this rule would create serious inefficiencies in the market to the extent that the price of breach exceeded the cost of compensating the victim.\(^3\)

From the preceding analysis, it is apparent that strictly enforcing all liquidated damage clauses, thereby treating them as exceptions to

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\(^1\) Cf. text accompanying notes 12 & 13 supra.
the ordinary policy of compensation, would produce inefficiencies in the market. However, this does not mean that liquidated damages can serve no function in the market. Through an agreement on damages, a potential plaintiff may avoid the practical problems of proving actual damages, which would reduce the cost of breach and encourage the formation of contracts. Moreover, by enforcing such agreements in cases where proof of actual damage might otherwise be lacking, the law may also effectuate the policy of compensation. Clearly, what is needed is a rule which would ensure that a liquidated damages clause is enforced only when it is consistent with the market allocation.

Liquidated Damages as Prima Facie Evidence

A liquidated damages clause should be treated as prima facie evidence of damages for breach. When a breach is shown, a presumption should arise in favor of the plaintiff that the amount computed under the liquidated damages clause is the proper recovery. The defendant would then have the opportunity to rebut this presumption by proving that the actual loss was less. In an action for breach of contract, where breach has been shown, but where determining the dimensions of damage is very difficult, plaintiff will be relieved of the burden of proving damages and awarded the liquidated amount. Yet the over-

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34 See text accompanying note 14 supra.
An individual defendant may in some instances be unable to prove a discrepancy between actual loss and the amount provided in the liquidated damages clause, although a discrepancy does exist in some absolute sense. Often the problem will be de minimis. To the extent that there is a serious discrepancy, this must be accepted as an imperfection of contract damages in general. When the difficulty of proof of damages is transferred from plaintiff to defendant through a liquidated damages clause, the parties have merely allocated a risk which should be allocated. That is, the parties should be permitted to allocate the risk of non-persuasion. See text accompanying note 72 infra.

However, where it appears that this risk was not freely bargained, as where one party lacked essential information or the bargaining was grossly unequal, the court would still be free to invalidate a liquidated damages clause on the grounds of adhesion or unconscionability. Cf. Sweet, Liquidated Damages in California, 60 CALIF. L. REV. 84, 144 (1972).

36 Professor Sweet in his study, Liquidated Damages in California, 60 CALIF. L. REV. 84, 142-45 (1972), makes a similar suggestion, although he would leave in place most of the common law tests of "reasonableness" and shift the burden on those issues to the defendant. The solution here differs somewhat in that it would eliminate any resort to the "reasonableness" test and focus solely on proof that the liquidated damages clause provides a recovery in excess of actual loss. See text accompanying note 67 infra.

37 See note 71 infra.
38 In a jury trial, the jury would be instructed that they are to find for the plaintiff in the amount liquidated, unless the defendant has proven by a preponderance of the evidence that the damages are less. If the defendant meets this burden, the jury would find for the plaintiff in the amount of his actual damage. It would, of course, be open to the
compensation that results when liquidated damages are shown to exceed actual loss is prevented.\(^\text{39}\)

Such an approach presents two problems, however. First, courts have generally not described liquidated damages as prima facie evidence. Second, courts have not allocated the burden of proof in the manner suggested by the proposed rule. Each of these points will be addressed to ascertain whether they are impediments to the treatment of liquidated damages as rebuttable prima facie evidence.

\textit{"Reasonableness"}

Rather than treating liquidated damages as rebuttable prima facie evidence, courts employ a complex maze of doctrine. Within this framework, courts have generally considered the decisive test of a liquidated damages clause to be the "reasonableness" of the recovery that it provides.\(^\text{40}\) To determine whether the amount of the recovery is reasonable, the courts will often consider evidence that the parties expected proof of actual loss to be difficult,\(^\text{41}\) that the amount stipulated approximated the probable loss,\(^\text{42}\) or that the parties "intended" to estimate the damage.\(^\text{43}\) Ironically, proof of actual loss has often been said to be irrelevant,\(^\text{44}\) or relevant only to determining the "reasonableness" of the prediction made by the parties.\(^\text{45}\)

\(^{39}\) The proposed rule is offered only for cases where the bargaining has been fair. In the ordinary commercial contract case, the correct result is more likely if it is presumed that the parties have bargained to a proper allocation of resources. Where there is evidence of adhesion, however, the "bargain" is much less likely to reflect the market solution. Where adhesion is shown, the liquidated damages clause should not be given presumptive force. See note 26 supra. See also Sweet, Liquidated Damages in California, 60 CALIF. L. REV. 84, 144 (1972).

However, it is possible that in some cases enforcement would be unjust, although "unconscionability" could not be shown. This likelihood is reduced by permitting the defendant to prove the result would be unjust—i.e., to prove that the actual loss is less. Many questions of adhesion are then resolved by preventing the result which adhesion doctrine aims to avoid. \textit{ Cf. Schwartz, Seller Unequal Bargaining Power and the Judicial Process, 49 Ind. L.J. 367, 392 (1974).} Professor Schwartz points out that unequal bargaining power should be a relevant consideration only when the result violates public policy. Otherwise, there is no reason for striking down agreements. Perhaps this result-oriented approach would serve to lighten the load which the unconscionability doctrine presently must bear. \textit{ Cf. also R. Posner, Economic Analysis of Law 53-55 (1973).}

\(^{40}\) See cases cited note 19 supra; see also UNIFORM COMMERCIAL CODE and the RESTATEMENT OF CONTRACTS, note 18 supra.

\(^{41}\) See note 47 infra & text accompanying.

\(^{42}\) See note 52 infra & text accompanying.

\(^{43}\) See note 57 infra & text accompanying.

\(^{44}\) See cases cited note 19 supra.

\(^{45}\) See, e.g., Frick Co. v. Rubel Corp., 62 F.2d 765 (2d Cir. 1933) (L. Hand, J.); UNIFORM COMMERCIAL CODE § 2-718(1), supra note 18.
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Despite an apparent disdain for evidence relating to actual loss, these tests do not exclude such evidence. In fact, in utilizing these tests, the courts are often able to determine whether the actual loss could be proven. A decision that a liquidated damages clause is "reasonable" is often a finding that the defendant could never show that the liquidated damages exceed actual damage. Often, when it is clear that the amount liquidated exceeds actual loss, the courts will find that the agreement of the parties was somehow "unreasonable," and refuse enforcement. 46

1. Difficulty of Proof of Actual Loss

In many cases, the courts have pointed to the difficulties of proof which the parties had anticipated at the time of contract as grounds for enforcement. In In re Lion Overall Co., 47 the defendant failed to make timely delivery of 25,000 military uniforms to the government in 1940. As the court recognized:

The contract was made for an article of military equipment for our troops at a time when the war clouds from Europe were gathering ominously about this country and when it could reasonably be anticipated, certainly by the Army and Navy Departments, that sooner or later we might be embroiled in the conflict. While there were others in the country who were manufacturing similar garments, what damage might result from a delayed delivery could not be ascertained with accuracy. 48

46 See text accompanying note 51 infra.

In asking, for example, whether the amount provided in the liquidated damages clause was reasonably within the parties' contemplation of damages, the court will naturally look to the situation at the time of trial, despite protestation that it is the moment of contract that is decisive. Cf. 5 A. CORBIN, CORBIN ON CONTRACTS § 1063 (1964).

This much has expressly been admitted in some cases, where evidence of actual loss was thought to bear on the "reasonableness" of the prediction made by the parties. See Frick Co. v. Rubel Corp., 62 F.2d 765 (2nd Cir. 1933) (L. Hand, J.). This position provides an intermediate ground for examining actual loss.

On the other hand, many courts, discarding the fiction that actual losses are irrelevant or only partially relevant, have proceeded to strike down liquidated damages clauses simply because the amount provided was wholly disproportionate to any actual losses sustained. See, e.g., Broderick Wood Prods. Co. v. United States, 195 F.2d 433 (10th Cir. 1952); Tennent v. Leary, 82 Ariz. 67, 308 P.2d 693 (1957); Quaille & Co. v. William Kelly Milling Co., 184 Ark. 717, 43 S.W.2d 369 (1931); Hyman v. Cohen, 73 So. 2d 394 (Fla. 1954); Nichols v. Knowles, 87 Idaho 550, 394 P.2d 630 (1964); Burnett v. Nolen, 336 Ill. App. 376, 84 N.E.2d 155 (1949); Beiser v. Kerr, 107 Ind. App. 1, 20 N.E.2d 666 (1939); McMurray v. Faust, 224 Iowa 50, 276 N.W. 95 (1937); Davidow v. Wadsworth Mfg. Co., 211 Mich. 90, 178 N.W. 776 (1920); Blunt v. Egeland, 104 Minn. 351, 116 N.W. 653 (1908); Plymouth Sec. Co. v. Johnson, 335 S.W.2d 142 (Mo. 1960); Seidlitz v. Auerbach, 230 N.Y. 167, 129 N.E. 461 (1920)


48 Id at 791.
Thus, the court enforced the liquidated damages clause since it was "reasonable" given the difficulties of proof anticipated at the time of contract.

Clearly, however, the damages sustained in this case had not become more easily ascertainable by the time of the trial. Indeed, given the complex circumstances of the damage issue, the defendant would never have been able to prove that the actual damages were less. Therefore, despite the court's use of a "reasonableness" test, the result in this case is perfectly consistent with treating liquidated damages as prima facie evidence—where there is insufficient evidence to prove actual loss, the amount liquidated should be awarded.49

Cases in which it can be shown that the actual loss is less than the amount specified in the liquidated damages clause present a different issue. In The Colombia,50 liquidated damages for delay were included in a ship repair contract. Although the defendant completed the repairs a month after the date promised in the contract, he was able to show that no charter had become available to the ship's owner during this

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49 It may well be that cases such as Lion Overall, which involve suits by the government, should be discounted entirely on the ground that the government may enforce a penalty. See, e.g., Weathers Bros. Transfer Co. v. United States, 109 Ct. Cl. 310 (1947) (liquidated damages clause for delay in transporting army officers' effects enforceable despite absence of pecuniary loss to the government). However, opinions replete with expansive language to the effect that actual loss is irrelevant appear in many cases between private parties. For instance, in Mead v. Anton, 33 Wash. 2d 741, 207 P.2d 227 (1949), the court refused to consider evidence that the actual loss was less than the amount provided in a liquidated damages clause on the assumption that such evidence is generally irrelevant. In that case, however, the issue was the amount of damages resulting from breach of a covenant against competition. Any evidence of actual loss would surely have been speculative in such a situation. See Sweet, Liquidated Damages in California, 60 Calif. L. Rev. 84, 124-25 (1972). The defendant in Mead could hardly have hoped to demonstrate a discrepancy between actual loss and the recovery provided in the liquidated damages clause. Thus, the decision in Mead cannot stand for the broad proposition that actual loss is always irrelevant. The issue has been overstated in other cases of this sort. Cf., e.g., United States v. Bethlehem Steel, 205 U.S. 105 (1907) (contract to deliver guns to the military providing per diem damages for delay); United States v. LeRoy Dyal Co., 186 F.2d 460 (3d Cir. 1950) (breach of an agreement to buy only the potatoes of approved growers, as part of a government price support system); Stephens v. Essex City Park Comm., 143 F. 844 (3d Cir. 1906), cert. denied, 201 U.S. 648 (1906) (damages for delay in completion of park facilities); Banta v. Stamford Motor Co., 89 Conn. 51, 92 A. 665 (1914) (delay in repair of a yacht).

In a few cases, however, dictum from United States v. Bethlehem Steel, supra, to the effect that no actual loss is necessary for enforcement of a liquidated damages clause, has developed into a holding. Cf. Ellicott Machine Co. v. United States, 43 Ct. Cl. 232 (1908) (government admitted it suffered no damage, yet was allowed to recover $25 per day for delay in delivery of a ship); Byron Jackson Co. v. United States, 35 F. Supp. 665 (S.D. Cal. 1940) (semble); Southwest Engineering Co. v. United States, 341 F.2d 998 (8th Cir. 1965) (semble). These cases represent the enforcement of penalties as generally understood. See 5 A. Corbin, Corbin on Contracts § 1062 n.45 (1964).

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period and that, even had repairs been completed on schedule, the ship would have remained idle. While the prediction of damages was almost certainly "reasonable," this was an insufficient ground for enforcement in light of the evidence that there were no actual damages. Clearly, this result is consistent with the proposed rule. The defendant could rebut the prima facie effect of the liquidated damages clause by introducing evidence that the actual loss was less.

2. Probable Loss

Some courts have examined the "reasonableness" of liquidated damages in terms of the anticipated or "probable" loss caused by the breach. In Konner Rental Corp. v. Pedone, the defendant breached his promise to lease two of the plaintiff's trucks. Defendant, however, was able to show that the plaintiff could have relet the trucks, thereby avoiding some damages. The court found the liquidated damages clause to be unreasonable because it was not an accurate forecast of the "probable" loss.

This case demonstrates a phenomenon recognized by Professor Corbin: that courts faced with a liquidated damages clause tend to structure their analysis around what could have been foreseen at the time of contract. However, if the question is what losses should rea-

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51 In a case such as this, the "reasonableness" of the parties' prediction of damages may be evident, yet the courts will refuse to enforce the liquidated damages clause. Cf. Norwalk Door Closer Co. v. Eagle Lock & Screw Co., 153 Conn. 681 689, 220 A.2d 263, 268 (1966):

It is not the function of the court to determine by hindsight the reasonableness of the expectation of the parties at the time the contract was made, but it is the function of the court at the time of enforcement to do justice.

Many cases have refused to award the liquidated amount where there was no evidence that plaintiff had been damaged by breach. E.g., Rispin v. Midnight Oil Co., 391 F. 481 (9th Cir. 1923); Miller v. Macfarlane, 97 Conn. 299, 116 A. 335 (1922); Gorco Constr. Co. v. Stein, 256 Minn. 476, 99 N.W.2d 69 (1959); Hathaway v. Lynn, 75 Wis. 186, 43 N.W. 956 (1889). Cf. Restatement of Contracts § 339, comment e (1932):

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


54 Id. at 71, 269 N.Y.S.2d at 463.
reasonably have been anticipated, it is only natural that a court's determination on that issue would be affected by the facts which are available at trial.\(^5\)

Thus stripped of its facade of "reasonableness" dogma, the court's inquiry into the accuracy of the estimate of probable loss greatly resembles the inquiry under the proposed "prima facie" rule: whether the defendant could show that the liquidated damages exceed the actual loss. In fact, since the defendant would have been able to make such a showing, the results under either approach are consistent.\(^6\)

3. The "Intention" of the Parties

Many decisions,\(^7\) particularly those of the United States Supreme Court,\(^8\) place an emphasis on whether the parties "intended" to make a genuine pre-estimate of damages. It is evident, however, that the courts will not enforce a liquidated damages clause that is otherwise unreasonable simply because the parties intended it to be "reasonable."\(^9\)

Moreover, the only evidence of intention which is available in most cases is the contract itself, since the parties do not ordinarily record bargaining concerning liquidated damages.\(^6\) The court must therefore fall back to a consideration of all the circumstances of the contract, with the intention of the parties becoming a conclusion around which the court may write its opinion.

For instance, in *Kothe v. Taylor Trust*,\(^6\) the Supreme Court considered the validity of a liquidated damages clause in a leasing agreement. The agreement provided that, upon breach by the lessee, the lessor could re-enter the property and recover as damages the full amount of the rent for the remaining term of the lease. The Court found this amount of damages disproportionate to the "anticipated" loss.\(^6\) The Court concluded that this "circumstance tends to negative any notion

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\(^{55}\) Cf. 5 A. CORBIN, CORBIN ON CONTRACTS § 1059 (1964). *See also* note 46 *supra.*

\(^{56}\) By directly addressing the question of actual loss, on the other hand, such mental gymnastics can be avoided, and the courts will be able to reach the correct result without the manipulation of doctrine. *See* text accompanying note 67 *infra.* Cf. *Sweet, Liquidated Damages in California,* 60 CALIF. L. REV. 84, 131-36 (1972); *Note, Liquidated-Damages Clauses in Real Estate Contracts,* 4 U. FLA. L. REV. 229, 234-35 (1951).


\(^{59}\) See 5 A. CORBIN, CORBIN ON CONTRACTS § 1058 (1964).

\(^{60}\) Id.

\(^{61}\) 280 U.S. 224 (1930).

\(^{62}\) Id. at 226.
that the parties really meant to provide a measure of compensation..." and refused to enforce the liquidated damages clause.

While analysis in terms of "intention" appears to give freer rein to contracting parties, the courts, as in this case, do consider evidence of actual loss which ultimately controls. Such an approach is consistent with the proposed rule which would dispense with intention altogether.

While the tests discussed above may seem, in form, antithetical to treating liquidated damages as prima facie evidence of loss, rebuttable by evidence that actual loss is less, their usage and effect are consistent with such a rule. In practice, these tests permit courts to examine evidence bearing upon actual loss which will often be conclusive, despite the common assertion that actual loss is irrelevant.

Since the courts have considered actual loss in the past, the adoption of a "prima facie evidence" rule would not alter the result of many cases. As one court has recognized, when the law enforces a liquidated damages clause,

\[ \text{[it]} \ldots \text{does not lose sight of the principle of compensation, which} \]
\[ \text{is the law of the contract, but merely adopts the computation or} \]
\[ \text{estimate of the damages made by the parties, as being the best and} \]
\[ \text{most certain mode of ascertaining the actual damage.} \]

When evidence of actual loss can be produced, the value of the liquidated damages clause as the best evidence of damages is lost. If the court is not to lose sight of the principle of compensation, liquidated damages should be rebuttable by evidence of actual loss.

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63 Id.


65 Similarly, many cases have drawn a distinction between uncertainty of the damages at time of contract, and uncertainty of the damages at time of trial, and have ruled that the former is the only relevant uncertainty for purposes of determining the enforceability of a liquidated damages clause. This distinction, which again implies that proof of actual loss is irrelevant if the prediction of the parties was reasonable, is questionable. In the cases which establish this distinction, the damages were at least as uncertain after breach as they were before. There was no need to reach the metaphysical distinction between anticipated and actual uncertainty of loss, since actual uncertainty was evident at time of trial. See, e.g., Gustav Hirsch Org. v. Eastern Ky. Rural Elec. Co-op Corp., 201 F. Supp. 809 (E.D. Ky. 1962) (delay in constructing lines for transportation of high voltage electric current); Associated Press v. Emmett, 45 F. Supp. 907 (S.D. Cal. 1942) (breach of membership agreement by member of news-gathering association); Robbins v. Plant, 174 Ark. 639, 297 S.W. 1027 (1927) (breach of covenant against competition); Downtown Harvard Lunch Club v. Racso, 201 Misc. 1087, 107 N.Y.S.2d 918 (1951) (breach of lessor’s promise to provide food and drink, with resulting loss of dues, inconvenience to club members, etc.); Callanan Road Imp. Co. v. Colonial Sand & Stone Co., 190 Misc. 415, 72 N.Y.S.2d 194 (Sup. Ct. 1951) (breach of sales agreement; buyer unable to cover in the market given monopoly conditions at time of breach).

Rather than addressing actual loss through a complex overlay of doctrine, courts could reach the same question directly by asking whether evidence of actual loss rebuts the liquidated damages clause. Conceptual ambiguities and anomalies in the present law would be resolved. By abandoning speculation as to the "uncertainty" of the damages, their relation to probable or actual loss, or the "intention" of the parties, and by requiring proof that actual loss is less, courts could resolve the issue cleanly.

Finally, a rule treating liquidated damages as prima facie evidence would be easily applied and would produce predictable results, thus reducing the risk of error. Since the parties would be able to predict the outcome of litigation more easily, settlements would be encouraged, reducing litigation and fostering judicial economy.

**Burden of Proof**

The other objection to the proposed rule is that courts have not placed the burden of proving actual loss on the defendant as would the proposed rule. Instead, after finding that a liquidated damages clause is unenforceable, the courts have proceeded to place the burden of proof

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68 Cf. cases cited note 65 supra.

The related "difficulty of proof" requirement should also be abandoned. Cf. text accompanying note 47 supra. Professor Macneil observes that there are at least five meanings that could be attributed to the "difficulty of proof" test. Macneil, Power of Contract and Agreed Remedies, 47 CORNELL L.Q. 495, 502 (1962).

69 See text accompanying note 52 supra.

70 See cases cited note 57 supra.

71 Recently the suggestion has been made that tort law would benefit from the employment of a similar device. This would be a resort to a traditional technique of the law—the development of an elaborate network of substantive presumptions which will allow us to reach sound systematic results by an indefinite series of approximations, each of which will move us closer to a fuller statement of the substantive law. These presumptions do not necessarily decide a case in a given manner, but each indicates that the result must go one way on the strength of the facts alleged, unless the other party is able to give some 'good reason' why it should not. Epstein, Defences and Subsequent Pleas in a System of Strict Liability, 3 J. LEG. STUD. 165, 166 (1974).

In a similar fashion, contract law may be able to transform factual questions into questions of law, and thus reach more systematic and coherent results. Cf. G. Gilmore, The Death of Contract 42 (1974). By resolving liquidated damage questions through a rebuttable presumption, it will be possible to ensure an approximation of the proper result.
of actual loss upon the plaintiff.\textsuperscript{72} Such an approach unnecessarily reduces the effectiveness of a liquidated damages clause. If it is possible to prove the extent of the damages, either party to the contract should generally be able to do so. Where it may not be possible to prove actual loss, the parties should be permitted to allocate the risk of non-persuasion.

In casting upon the defendant the burden of proving that the actual loss is less than the amount liquidated, the proposed rule is consistent with the general principle that the burden of proving contract defenses rests with the defendant. Proving the defenses of impossibility,\textsuperscript{72} mistake,\textsuperscript{72} fraud,\textsuperscript{72} duress,\textsuperscript{72} and illegality,\textsuperscript{72} is a burden placed on the defendant. The law has generally presumed that bargains are enforceable and therefore required the party who asks the court to intervene against an otherwise enforceable bargain to demonstrate the need to do so.\textsuperscript{72}

Under the rule proposed, the defendant is called upon to show that the recovery provided in a liquidated damages clause is inconsistent with the allocation made by the competitive market. That is the same burden


\textsuperscript{72} Beyond bearing the burden of proof, the defendant should perhaps also be required to bear the costs of litigating a liquidated damages clause. These costs should be made part of the calculus of a party contemplating breach, since they are social costs which breach will entail. See Birmingham, \textit{Breach of Contract, Damage Measures, and Economic Efficiency}, 24 Rutgers L. Rev. 273, 285 (1970).
faced by a defendant who alleges frustration of purpose or impossibility, affirmative defenses ensuring that the obligations of contracting parties will be adjusted to reflect altered market situations. Thus, the proposed rule would also be consistent with the general body of contract law.

CONCLUSION

Liquidated damages should be treated as prima facie evidence of loss, rebuttable by evidence that actual loss is less. This rule directly confronts the most relevant issue: would award of the amount provided in the liquidated damages clause compensate the innocent party consistently with the requirements of a competitive market? Where the liquidated amount approximates actual loss, the defendant will be unable to rebut the presumption in favor of the liquidated damages clause and the amount liquidated will fairly compensate the plaintiff. Where the amount


Professor Birmingham demonstrates that:

[M]odern courts have been increasingly unwilling to maintain the fiction of classical theory that contracting individuals have negotiated an optimal equilibrium which it would be presumptuous to disturb.

1969 DUXE L.J. 49 at 53.

Rather, the courts will intervene when some public policy is disturbed. Furthermore, as Birmingham shows, such intervention is necessary where the perceived market positions of the parties change, rendering enforcement inequitable.

Moreover, the pervasive contracts doctrine of the “duty” to mitigate or to avoid loss caused by breach is calculated to impose upon the defendant only the costs of breach as dictated by the market. Whatever damages may have been foreseen or appear to have occurred, it is always open to defendant to show that plaintiff failed to take advantage of market substitutes for performance. Where this can be shown, it is evident that the damage remedy plaintiff asks is to some extent unnecessary since the market itself has provided his remedy. Accordingly, plaintiff’s recovery is reduced by the amount of the damages that were avoidable. See S A. CORBIN, CORBIN ON CONTRACTS § 1039 (1964).

provided in the liquidated damages clause exceeds actual loss, the defendant will be able to prove this and the plaintiff will then be awarded only his actual damages, thus achieving the goal of compensation and thereby maintaining market mobility. Where the actual damages are impossible or very difficult to prove, the parties' allocation of the risk of non-persuasion will be enforced.

James Patrick Fenton

80 Where plaintiff's actual loss exceeds the amount liquidated, somewhat different concerns are involved. In order to protect contracting parties from inordinate risks, the courts will generally enforce fairly bargained limitations on liability. Cf. Fritz, "Underliquidated" Damages as Limitation of Liability, 33 Tex. L. Rev. 196 (1954). Judicial sympathy toward such limitations is probably in large part a product of the rule in Hadley v. Baxendale, 156 Eng. Rep. 145 (ex. 1854), which, by one interpretation, means that a party must affirmatively accept liability for consequential or special damages. This, in turn, has come to mean that contract damages may be limited by the contract. Cf. Globe Refining Co. v. Landa Cotton Oil Co., 190 U.S. 540, 543-44 (1903) (Holmes, J.).