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Liability Risks

LIABILITY HAZARDS

An obligee who expects to realize a specified amount of value from a transaction will expect compensation at least in that amount from its obligor when the latter's breach causes an unsuccessful outcome and loss of such value. If, at contract formation, the extent of those damages cannot be determined because conditions and contingencies are unknown at that time, then the compensation that the obligee may expect remains to be determined until the conditions are known and the contingencies have occurred; the damages are uncertain. When such damages are known, whether at contract formation or later, the applicable law may not allow the obligee to recover all its losses. Such damages are irrecoverable. At contract formation, the hazard to the obligee is the uncertainty of the damages it may recover for breach and the losses it may be unable to recover under applicable legal rules. Uncertainty is also a hazard to an obligor, because at contract formation it may be unable to determine the amount of its potential liability. The law also may allow the obligee to recover damages that the obligor did not anticipate could be awarded for breach of contract. The hazards to the obligor are damages that are uncertain or unexpectedly recoverable.

Inadequate and Excessive Compensation

The relief to which a party is entitled under the applicable law may fall short of or exceed that party's expectations. The relief falls short of expectation when the value of the relief available to a party injured by a breach of contract is less than the value it expected to realize and would have realized had the transaction been successfully completed. For example, in the textbook case *Hadley v. Baxendale,*[1] the owners of a flour mill in Gloucester lost five days' revenue because the carrier delayed delivery of their broken crank shaft to engineers in Greenwich but were not entitled to compensation for their lost profits, having not made the carrier aware that their mill was shut down until a new crank shaft was delivered. The owners were not entitled to compensation for value they expected to but did not realize because the operations resumed five days later than expected. The hazard to the mill owners was the limitation on the damages they could recover from the carrier for breach; the risk was the chance that they might suffer those losses.

The relief exceeds a defaulting party's expectation when the value of the relief available to a party injured by a breach of contract exceeds the losses the defaulting party expected the injured party to incur as a result of its default. For example, if, in *Hadley v. Baxendale*, the carrier had been held liable for the mill's lost profits, the mill owners would have received compensation for losses the carrier did not expect the mill owners to incur had the transaction been unsuccessful. The hazards are the discrepancies between the rules that determine the damages to which the injured party is entitled and either its expectations as to damages it should recover or the defaulting party's expectations as to the damages for which it should be liable. The hazards occur when the parties crystallize their expectations about such damages.

Uncertainty

At contract formation, the parties may or may not have sufficient information to forecast the losses that will likely result from an obligor's breach of contract. If a party has sufficient information, it should have reasonable certainty about the defaulting obligor's liability. Such obligor should be able to understand the extent of its potential liability and the obligee the extent of its potential losses and compensation. A party may have insufficient information to forecast such damages because the conditions and contingencies that will significantly affect the extent of the losses that result from a breach are unknown at contract formation and vary so widely that calculation of damages is not reducible to a formula. That information may or may not be available, depending upon whether the applicable conditions and contingencies are knowable at contract formation. An obligor, understanding uncertainty about forecasting the losses that result from breach, may have only vague expectations about its potential liability. An obligee, understanding this uncertainty, may have only vague expectations about its possible losses. Each party's expectations about liability and compensation might not crystallize before breach, at which time the parties are likely to disagree about the extent of losses and liability. Such uncertainty about liability and compensation is another instance of condition and contingency uncertainty and is a hazard to each party at contract formation.

An additional uncertainty that concerns litigants is the unpredictability of the cost of litigation or an arbitral proceeding and the amount of compensation that might be awarded as damages in a trial, by judge or jury, or an arbitral proceeding. The cost and effort required for a trial, arbitration, or other dispute resolution proceeding, which will depend upon the complexity of the dispute and the actions of the disputing parties, will be unknowable contingencies at contract formation. The potential for a dispute, taken together with the potential costs of resolving it, is a potential hazard at contract formation. The unpredictability of court, arbitration, and other decisions about compensation may be attributable to those institutions and not entirely to the peculiar facts or legal issues in the disputes. This is an instance of the uncertainty described in chapter 6: inept, biased, or corrupt administration of justice that undermines the certainty of legal rules and the parties' commitments in a contract. The solutions to that uncertainty risk, discussed in chapter 6, apply to the unpredictability of decisions about liability and compensation attributable to incompetent, biased, and corrupt administration of justice.

LIABILITY RISK MANAGEMENT

Contract law rules that govern the damages to which a party is entitled following a material breach by the other party allocate responsibility for the risk that its losses may exceed the amount of compensation to which it is entitled. To the extent effective, express terms in a contract can modify such risk allocation. An obligor assumes responsibility for the risk that damages that fall within the conditions and limits exceed the amount for which it anticipated it could and would be liable. The most common strategies for limiting liability, summarized in this chapter, include

- liquidated damages, which, when enforceable, stipulate the amount of compensation that the injured party may claim,
- damage exclusions, which limit or exclude types of damages for which recovery is permissible,
- remedy limitations and exclusions, which require that an obligee resort to specific remedies and not others,
- limits on money damages, within agreed bands or maximum amounts,
- limits on the persons and assets to which recourse for damages is permissible,
- private statutes of limitations that limit the periods within which claims must be asserted, and
- periodic releases, which extinguish claims that existed prior to the release.

Liquidated Damages

Liquidated damages, defined as "[a]n amount contractually stipulated as a reasonable estimation of actual damages to be recovered by one party if the other party breaches,"[2] can mitigate uncertainty about the damages that can be recovered for a breach of contract. At contract formation, the choice for each party is between continuing with that uncertainty and making assumptions about the conditions that will exist when a breach occurs and estimating the damages that will likely occur. The obligee trades responsibility for such uncertainty risk for another: responsibility for the risk that actual damages may be more than the agreed amount. The obligee self-insures its losses above the agreed amount when its recovery is limited to that amount. No such trade is made, however, when the obligee can recover the excess. The obligor trades uncertainty risk for another: the risk that actual damages will be less than the liquidated damages when it is liable for the stipulated amount notwithstanding such discrepancy. No such trade occurs when the obligor is not liable for the excess over actual damages.

The following cases illustrate such risk allocations:

- *Noble v. Ogborn*[3]: A contract for the sale of real property provided "In the event of default by Buyer, Seller shall have the election to retain the earnest money as liquidated damages, or to institute suit to enforce any right Seller has. . . ." After the buyer breached, the seller sued for $30,383.97 in damages instead of retaining the $1000 deposit. The seller, but not the buyer, mitigated its uncertainty risk, because the seller could elect to keep the deposit or sue for actual damages; the buyer had no such choice.[4]
- *Truck Rent-a-Center, Inc. v. Puritan Farms 2nd, Inc.*:[5] A truck lease provided:

  > Upon termination of this agreement, . . . Lessor . . . shall be entitled to damages, herein liquidated for all purposes . . . as follows: (a) The sum of all rents designated as "Fixed Rental Charges" which would have become due under the normal operation of this agreement from the date of the said termination . . . including any effective renewal period; less (b) the re-rental value of said motor vehicles which is hereby agreed upon as fifty per cent (50 percent) of the sum of such "Fixed Rental Charges" as are set forth in subdivision "(a)" of this article.[6]

  The lessee had an option to purchase the leased trucks, which at the time it wrongfully terminated the lease would have cost $48,134.17. Its liability for liquidated damages, however, was $92,341.79. Because the lessor's residual interest in the equipment was limited to the purchase price, the additional damages covered by the liquidated damages clause were a windfall to the lessor. The clause mitigated uncertainty risk for both parties, but the lessee assumed responsibility for the risk its liability for liquidated damages could be more than the value of the lessor's residual interest at the time of breach.[7]
- *Vines v. Orchard Hills, Inc*.[8]: In 1973, a real property buyer paid $7,880 as a down payment on a purchase price of $78,700 but repudiated its obligation to pay the balance and take title to the land. The contract provided that the down payment could be retained by the seller as liquidated damages.[9] The buyer sued for his down payment to be refunded. In 1979, when the case came to trial, the property was valued at $160,000.[10] The value of the land in 1973, when the buyer repudiated, was relevant and if shown to be more than the price, would relieve the buyer of liability for damages. The liquidated damages clause operated as a limit on the buyer's liability: it could be liable for damages up to the deposit amount.[11]

Partial Breaches. A liquidated damages clause may estimate the damages an obligee suffers upon a breach that deprives it of the benefits of its bargain. This was achieved in *Noble*[12] and *Truck Rent-a-Center, Inc*.:[13] the seller in the first case hoped to realize the value of the land to be sold to the buyer, and the lessor in the second expected to realize the lease rentals for the remainder of the lease term. Liquidated damages may also estimate the damages that result from a minor or partial breach—a partial failure to complete a task that is expected to contribute to benefit realization notwithstanding such failure or a failure to comply with a regulatory or other minor covenant. Late payment is an example of the former: the payee's damages are minor in comparison to no payment at all. Failure to deliver a notice is an example of the latter. Delay damages in a construction contract are another: late completion of a project does not necessarily substantially deprive the project owner of its anticipated benefits. Their true purpose may be to coerce performance or deter breach.

Following are two cases that illustrate the coercive character of liquidated damages for partial breaches.

- *Venitron Corp. v. CF 48 Associates*[14]: A lease provided for liquidated damages in the amount of one year's rent for any breach thereof. Since the clause covered partial and material breaches alike, the amount payable was not proportionate to all breaches.
- *Ridgeley v. Topa Thrift and Loan Assn.*[15]: A loan agreement required payment of six months' interest upon prepayment of the loan unless the borrower had paid each installment no later than 15 days after its due date; in that event, the prepayment premium was excused. When the lender demanded and collected prepayment premia from borrowers who prepaid when selling their mortgaged properties, the borrowers sued. While a prepayment premium is usually compensation for the privilege of being allowed to pay before the due date, in this case the fact that it was payable only if the borrower had been delinquent in repaying the loan tainted the provision.[16]

Damage Exclusions

Damages may be compensatory or punitive according to whether they are awarded as the measure of actual loss suffered or as punishment for outrageous conduct and to deter future transgressions. Damages for losses that result from a breach or repudiation of contract may be

- direct or general, defined as "damages that the law presumes to follow from the type of wrong complained of"[17];
- consequential, defined as "losses that do not flow directly and immediately from an injurious act but that result indirectly from the act"[18];
- special, defined as "[d]amages that are alleged to have been sustained in the circumstances of a particular wrong"[19];
- expectation or expectancy, defined as "compensation awarded for the loss of what a person reasonably anticipated from a transaction that was not completed"[20];
- incidental, defined by way of an example: "any commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the buyer's breach, in connection with the return or resale of the goods or otherwise resulting from the breach"; and
- exemplary or punitive, defined as "damages awarded in additional to actual damages when the defendant acted with recklessness, malice, or deceit."[21]

A contract can exclude liability for one or more of such types of damages, thus limiting liability to those not excluded. A frequent exclusion includes punitive, consequential, special, and incidental damages and precludes an obligee from seeking recovery for its lost profits as a result of a breach by an obligor. Such an exclusion allocates to the obligee responsibility for the risk that it might suffer losses falling into one or more of the categories of excluded damages, effectively making it the self-insurer of them.

American Nursery Products, Inc. v. Indian Wells Orchards[22] illustrates a typical exclusion of consequential damages. A seller agreed to grow and deliver 700,000 apple trees the buyer intended to use to develop a 500-acre orchard. The contract provided,

> [t]he party declaring default shall have all rights provided under the Washington Uniform Commercial Code and other applicable laws of the State of Washington and the terms and provisions of this Agreement; provided that in no event shall Grower be subject to or liable for incidental or consequential damages.[23]

The seller delivered less than the agreed quantity, and a number of those delivered were rejected and others that were accepted died. The buyer sued, and the trial court, after holding the quoted provision was unenforceable as unconscionable, awarded judgment in the buyer's favor for $2.3 million, $1.7 million of which was for lost production. The Washington Supreme Court reversed the award of consequential and incidental damages, holding the exclusion clause enforceable. The buyer had assumed the risk it would incur consequential damages from breach by the seller.

Remedy Limitations

A contract can state certain remedies that may be exercised in response to a breach and it may further state that certain remedies may not be exercised. The permitted remedies may allow or require the obligor to correct defects in its performance. The objective of such provisions is to limit, if not eliminate, liability for money damages. Such remedy exclusions are not always enforceable, however.

The following illustrate such remedy limitations:

- *Frey Dairy v. A.O. Smith Harverstore Products, Inc.*[24] illustrates a repair and replace remedy limitation. A contract for the supply of a silo included as the sole and exclusive remedy for breach of the express warranty (all other warranties were disclaimed) repair or replacement of the silo, at the manufacturer's option. The buyer claimed damages for the harm to its cows caused by the condition of the silo, which breached the warranty. Had the remedy limitation been unenforceable, as the buyer claimed, it could have sued for money damages. However, because the limitation was enforceable, the buyer had assumed responsibility for the risk it could incur losses before the defects were corrected.[25]
- *Banc of America Securities LLC v. Solow Building Co. I, L.L.C.*[26] illustrates a specific performance-remedy-only limitation. A lease provided

  > Tenant hereby waives any claim against Landlord which Tenant may have based upon any assertion that Landlord has unreasonably withheld or unreasonably delayed any consent requested by Tenant, and Tenant agrees that its sole remedy shall be an action or proceeding to enforce any related provision or for specific performance, injunction or declaratory judgment or an arbitration proceeding.[27]

  The lease also provided that any dispute over tenant alterations could, at the tenant's option, be submitted to expedited arbitration. When the tenant requested the landlord's consent for tenant improvements and the landlord demanded a $6 million consent fee, the tenant sued for damages. Had the limitation previously quoted been effective even when the landlord failed to act in good faith, as the landlord claimed, the tenant would have assumed responsibility for the risk that it could incur losses before a court could award specific performance. But, as the tenant successfully claimed, that limitation should not apply in the exceptional case when the landlord does not act in good faith. The risk allocation implied by the clause did not apply in such a case, and responsibility for the risk that its breach of contract would cause losses by the tenant remained with the landlord.[28]

- *McIntire v. Green-Tree Communities, Inc*.[29] illustrates a "no damages for delay" limitation in a construction contract. A contract to build a house provided, "[T]he Seller cannot and will not be responsible for any damages or inconveniences caused to Buyer for failure to complete residence mentioned herein by such date, regardless of the reason for such delay." The buyer had a commitment for a mortgage at a fixed interest rate of 8 percent per annum, but because completion was four months late, it had to accept a mortgage at 8-3/4 percent. Had the clause been enforceable in all circumstances, including fraudulent and willful misconduct by the contractor, as the contractor claimed, the buyer would have assumed responsibility for the risk of losses resulting from delays that breached the contract. The buyer successfully claimed, however, that the limitation should not be effective when the contractor never intended or expected to complete the work by the scheduled completion date. The buyer assumed responsibility for the risk it might suffer losses due to completion later than agreed but not when the contractor never intended or expected to complete on time.[30]

Damage Amount Limitations

Instead of excluding liability for money damages altogether, a contract can limit liability for breach or repudiation to certain amounts. Damages must be proved, but their recovery is subject to limitations. One such limit allows recovery for amounts an obligor receives or receives during specific periods of time. Another limits an obligor's liability to amounts above a minimum and below a maximum, below and above which, respectively, damages are not recoverable. The obligee self-insures losses below the deductible and above the cap. An agreement to refund the compensation or price paid by the obligee is analogous, as it limits the damages payable by an obligor to the amount received.

The following illustrate such remedy limitations:

- *Foont-Freedenfeld Corp. v. Electro Protective Corp*.[31]: Electro Protective Corp. (EPC) installed and maintained a burglar alarm system in Foont-Freedenfeld Corp.'s (FFC) apparel store. Their contract provided:

  > [EPC] the Contractor's liability hereunder shall be limited to and fixed at a sum equal to ten percent of the annual service charge hereinabove provided for, but in no event amounting to less than the sum of fifty dollars, as liquidated damages, and not as a penalty, and this liability shall be exclusive.[32]

  The store was burgled, resulting in losses of $55,423.13. Had the limitation not been effective because it was not a valid liquidated damages clause, as FFC claimed, EPC would have been liable for an amount considerably higher than $50. As a valid limitation, however, as EPC successfully claimed, FFC assumed responsibility for its losses that resulted from a breach by EPC could exceed that limitation.[33]

- *Computrol, Inc. v. Newtrend, L.P*.[34]: Computrol, which developed custom computer software for the financial services industry, agreed to reengineer certain of Newtrend's software applications. Computrol successfully sued Newtrend for breach of contract. The contract limited "each party's liability to the other for any cause whatsoever and regardless of the form of action and whether in contract or tort, or at law or equity . . . [to] the amounts actually paid to the other under this Alliance Agreement."[35] The sum of the modified contract price for Computrol's work on one project and the cost of the work performed on another project amounted to $469,206.88. Had the words "amounts actually paid" not precluded lost profits, as Computrol claimed, Computrol might have been able to recover more than $469,206.88, though it was uncertain what those additional damages might include.[36] Regardless, implicit in Newtrend's successful claim was that Computrol had assumed responsibility for the risk its losses could exceed the fees it would receive under the contract.[37]

Recourse Limitations

The scope of persons and assets to which a party may have recourse for breach of contract can be expanded or limited by contract. First, third parties may be brought into a transaction as guarantors and indemnitors of an obligor's liabilities thereunder. Conversely, third parties—persons not party to a contract—can obtain assurances from the parties that they will not be liable for breach of that contract. Such assurances are intended to avoid claims that a third party's separateness from a party to the contract should be disregarded and the two treated as one entity.

Hoosier Energy Rural Electric Coop., Inc. v. Amoco Tax Leasing IV Corp.[38] illustrates such a recourse limitation. Hoosier sold equipment to, and leased that equipment back from, Amoco Tax Leasing IV Corporation (Amoco Tax). The lease stated Hoosier's compensation for the equipment would be adjusted favorably if by June 30, 1983 the Internal Revenue Service issued regulations allowing the owner of the leased equipment to depreciate it over five, instead of fifteen, years. When the regulations were published on February 16, 1984, Hoosier claimed the adjustment, estimated to be between $25 million and $28 million, because the regulations were given retroactive effect and sued Amoco Corporation and Amoco Tax in an Indiana state court for unjust enrichment. When Amoco Tax filed notice to remove the case to federal court, asserting the diversity of the parties, Hoosier objected, asserting that as both Amoco Corporation and it were Indiana persons, no diversity existed. The lease, however, stated, in part, "No recourse shall be had for the payment of . . . any . . . amount payable hereunder . . . against, Amoco Leasing Corp. ([the defendant] Amoco's sole stockholder) or any other Affiliate of Amoco. . . ."[39] Notwithstanding this clause, Hoosier argued the parent corporation could be added as a party to its suit because it was unjustly enriched by the tax benefits it received from the transaction and which were referenced in the agreement. By accepting the limitation on its recourse to Amoco Tax, Hoosier assumed responsibility for the risk it would have to pursue its claim solely against that entity and in a federal court.[40]

Second, recourse for damages resulting from a breach of a contract may be further restricted to specific assets of an obligor, in which case the obligee cannot recover for its damages from the obligor's other assets. In effect, the parties identify a fund or pool of assets to which recourse is permissible to the exclusion of whatever other assets the obligor has. An example, one imposed by statute, is a limit on recourse to the property that secures a loan, the proceeds from which were used to buy it. Comparable limits may be crafted by contractual terms.

The following illustrate such limited recourse:

- *In the Matter of Vintero Corp.*[41]: A debtor granted a security interest in two vessels but limited the secured party's recourse for payment of the secured debt to the collateral. The vessels were moved to another state. The secured party failed to file a new financing statement, which filing was necessary to continue perfection of such security interest. As a result, the security interest no longer had priority in the vessels, leaving the secured party without a perfected security interest or priority when the debtor became bankrupt. The secured party was still entitled to recover from the proceeds from the sale of the vessels, though after other creditors had been satisfied. It was not permitted to have recourse against other assets of the debtor. The creditor assumed responsibility for two risks any secured creditor assumes: that it would fail to maintain the priority of its security interest and that the debtor's equity in the collateral might be less than the amount owed by the debtor to it. By agreeing to limit its recourse, the creditor also assumed responsibility for a further risk—that it would need but not have recourse to any of the other debtor's assets to be repaid.
- *Chevron U.S.A. Inc. v. Belco Petroleum Corp.*[42]: Chevron held an offshore oil lease from the federal government on the outer continental shelf off the Louisiana coast. It assigned its rights under the lease to Belco in return for a one-eighth overriding royalty payment from gas produced from the field. The agreement provided Chevron would receive its royalty in-kind. It also allowed either party to take less than its share and recover the difference in "balancing" payments at a later date. Chevron was owed such a balance when the field stopped producing. Belco claimed it had no obligation to pay such balancing payments in cash. If Chevron was correct, it had recourse to all of Belco's assets for payment in cash for the balancing payments. But Belco was correct, as the appeal court ruled; Chevron had agreed to limit its recourse to the in-kind payments from the field.[43] It thereby assumed responsibility for the risk the field would not produce sufficient gas to cover the balancing payments.

A party can also limit recourse to specific assets by selecting or forming an entity to participate in a transaction as the obligor, capitalizing it with the assets to which recourse is ultimately to be had and which are or will be sufficient to cover its liabilities. The obligee may exercise all remedies against that obligor for breach of contract, receiving payment for its damages from any and all assets of that entity. Whereas, in principle, a nonrecourse obligation limits the obligee's remedies to recovery from specific assets and a full recourse obligation allows an obligee recourse against all the assets of the obligor, this difference has little financial substance when the obligor is a special purpose entity formed to implement a single project, development, or transaction, capitalized with cash, cash equivalents, and other assets, the latter of which are useful or necessary for the transaction.[44] Recourse to the entire balance sheet of the special purpose entity obligor is effectively limited to those assets.

Private Statute of Limitations

The time for claiming damages for breach or repudiation may be limited to a period shorter than that otherwise permitted by law. A condition requires that notice of breach be given to the obligor within an agreed period of time. The time limitation operates as a private statute of limitations, setting a maximum time by which notice of claims must be given. Like a statute of limitations, it allocates to the obligee responsibility for the chance that it will not discover a breach until after the time for a claim has lapsed; to that extent that party self-insures the losses it sustains because it did not discover the breach.

Besicorp Group, Inc. v. Thermo Electron Corp.[45] illustrates the operation of a private statute of limitations. A subcontract between a contractor and subcontractor for the installation of an electricity-generating unit in a hospital included a warranty that read, in part, "[T]he Equipment is warranted for a period of six (6) months after delivery or 500 hours of operation, whichever first occurs, to be free from defects in material and workmanship."[46] After installation was completed, the contractor excluded the subcontractor from the site and operated the unit for 17 months and 4,000 hours before learning that the installation of the unit violated four electrical code provisions. The court held claims for these breaches of the warranty were barred by the limitations in the warranty, even if they were latent and even if the unit could not be repaired.[47] The contractor assumed responsibility for the risk the defects in the equipment might not be discoverable or discovered until after the six-month warranty period had expired.

Releases

An obligee may be required to deliver periodic releases, acknowledging that it has no claim, and releasing any claim it may have, against an obligor. Such releases are common in construction projects, where the contractor, upon receipt of periodic payment, acknowledges it has received payment in full for all work to date, save for retained amounts, and releases the owner of claims for such amounts. When commercial lenders agree to amendments, consents, and waivers, they sometimes ask their borrowers to acknowledge they have no claims and to release the lenders for any they might have. Any claims for damages are extinguished if the releases are properly drafted.

Sorrels Steel Co. v. Great Southwest Corp.[48] illustrates the scope of a form of releases periodically given pursuant to a construction contract. The subcontractor responsible for fabricating steel on a construction project incurred additional costs because of defects in the drawings and specifications and claimed such costs from the contractor. The contractor agreed to submit the claim to the city, which had provided the drawings and specifications. The subcontractor continued to receive defective drawings and to incur additional costs. It also received periodic payments, and executed nine releases, one of which read, in part:

> [Subcontractor] hereby releases . . . all their lien rights, claims and demands of every kind whatsoever, including any claims for extended or additional job costs and overhead and lost profits, due to any cause, including claims and demands arising from any claimed delays, disruptions or changes to the work. . . .[49]

Another form of release read, in part:

> [Subcontractor] hereby acknowledges that all materials heretofore furnished have been paid for in full, and [Subcontractor] . . . hereby remises, releases, acquits, satisfies and forever discharges [Contractor] . . . of and from any and all claims that it might have against [Contractor] . . . for furnishing materials for the aforementioned project.[50]

The subcontractor sued the contractor for its additional costs when its requested change order was not issued. If the releases covered the claims for extra costs, as the contractor claimed, then the subcontractor assumed responsibility for the risk each time it executed and delivered a release that it had relinquished whatever right it had to additional compensation. But, as the subcontractor successfully claimed, the releases covered only the work and claims for which it received payments; such was the nature of releases for progress payments. The releases did not alter the contractor's commitment to pay for the additional work.[51]

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1 9 Exch. 341, 23 L.J. (Ex.) 179, 23 L.T. (O.S.) 69, 18 Jur. 358, 2 W.R. 302, 2 C.L.R. 517, 17 Digest (Repl.) 91 (1854).

2 BLACK'S LAW DICTIONARY 473 (10th ed. 2014).

3 43 Wash. App. 387, 717 P.2d 285 (Wash. App. 1986).

4 The trial court awarded the seller $1000 plus attorney fees, and the seller appealed. The appeal court reversed, holding, "A liquidated damages clause does not preclude a party from suing for actual damages if that right is preserved in the contract between the parties." *Id*. at 390.

5 41 N.Y.2d 420, 393 NYS 2d 365, 361 NE 2d 1015 (N.Y. 1977).

6 41 N.Y.2d at 421, footnote 1.

7 The court held the purchase option was irrelevant to the validity of the liquidated damages provision, which was "related reasonably to potential harm that was difficult to estimate and did not constitute a disguised penalty." *Id*. at 427.

8 181 Conn. 501, 435 A. 2d 1022 (Conn. 1980).

9 "DEFAULT: In the event Purchaser fails to perform any of the obligations herein imposed on the Purchaser, the Seller performing all obligations herein imposed on the Seller, the Seller shall retain all sums of money paid under this Contract, as liquidated damages, and all rights and liabilities of the parties hereto shall be at an end." 181 Conn. at 503.

10 "The trial court relied on . . . [a $160,000 valuation in 1979] to conclude that, because the seller had gained what it characterized as a windfall of approximately $80,000, the purchasers were entitled to recover their down payment of $7880." *Id*.

11 The Connecticut Supreme Court reversed the trial court's decision, holding the buyer could submit evidence of the value of the property at the time of breach to show the seller had not suffered any loss.

12 See text accompanying notes 3 and 4.

13 See text accompanying notes 5–7.

14 104 A.D.2d 409, 478 NYS 2d 933 (N.Y. App. 1984).

15 17 Cal.4th 970, 73 Cal. Rptr.2d 378, 953 P.2d 484 (Cal. 1998).

16 The trial court held the prepayment premium was a penalty, not liquidated damages; the appeals court reversed; and a divided California Supreme Court reversed, upholding the trial court's finding. "To [the lender] Topa, moreover, the value of the disputed provision was clearly to be found in its operation as a penalty for late payment rather than as compensation for prepayment. After [the borrowers] plaintiffs made six months of interest payments (after June 21, 1991, that is), Topa would impose the prepayment charge only if during the period of the loan plaintiffs had made a late payment or were otherwise in contractual default. That contractual stipulation shows that, from Topa's viewpoint, the purpose of the threatened charge, after June 21, 1991, was to coerce timely payment of interest, not to compensate Topa for interest payments lost through prepayment of principal." 17 Cal. 4th at 980.

17 BLACK'S LAW DICTIONARY, *supra* note 2, 472.

18 *Id*.

19 *Id*. at 474.

20 *Id*. at 472.

21 *Id*. at 474.

22 115 Wn.2d 217, 797 P.2d 477 (Wash. 1990).

23 *Id*. at 221.

24 886 F.2d 128 (6th Cir. 1989).

25 The district court granted summary judgment, relying upon the repair or replace remedy, and the appeal court affirmed.

26 47 A.D.3d 239, 847 N.Y.S.2d 49, 2007 N.Y. Slip Op. 09545 (N.Y. App. 2007). For a summary of this case, see text accompanying ch. 7, note 52.

27 47 A.D.3d 239, 241.

28 The landlord moved to dismiss the complaint and for summary judgment on the basis of the quoted clause. The court denied the landlord's motions because the clause did not apply to a bad faith denial of the requested consent, and it was a question of fact if the landlord had acted in bad faith. The clause effectively limited the tenant to demanding that the landlord correct any breaches and allocated to the tenant the risk of losses that would result from such breaches, excluding bad faith breaches.

29 318 So.2d 197 (Fla. App. 1975).

30 The buyer sued for damages, alleging the seller never intended to complete by the scheduled date. The trial court dismissed the complaint, but the appeal court reversed, holding that while the "no damages for delay" clause was enforceable, an exception existed if the seller had engaged in fraud or willful misconduct, the former of which had been alleged by the buyer.

31 126 N.J. Super. 254, 314 A.2d 69 (N.J. Super. 1973).

32 126 N.J. Super. at 257–8.

33 FFC sued FPC for fraud and was awarded a $27,500 judgment. The appellate division reduced the judgment to $50, holding the clause was enforceable. FPC assumed the risk its losses caused by EPC's breach would exceed the $50 limitation.

34 203 F.3d 1064 (8th Cir. 2000).

35 *Id*. at 1069.

36 On post-trial motion, the district court described proof of damages in excess of $469,206.88 as wholly speculative.

37 Computrol sued for fraud and breach of contract. A jury awarded $2,663,000 to Computrol on the breach of contract claim. On post-trial motion, the district court ruled as a matter of law that a contractual limitation of liability provision limited Computrol's breach of contract recovery to $469,206.88. The district court entered judgment in Computrol's favor in the amount of $469,206.88 plus $150,000 in attorneys' fees. The appeal court affirmed the post-trial judgment of the district court. The court held the limitation clause was "intended to foreclose all future damages, i.e., prospective lost profits." As a result, the software developer's damages were limited to amounts it had been paid prior to breach by the customer.

38 34 F.3d 1310 (7th Cir. 1994).

39 *Id*. at 1315.

40 The district court granted the motion to dismiss the parent corporation from the suit, and the appeal court affirmed. Referring to the quoted language, the appeals court said, "This language broadly applies to any claim that is in any way 'based on' the sale-leaseback agreement or otherwise 'in respect to' the agreement." *Id*. at 1316.

41 735 F.2d 740 (2d Cir. 1984).

42 755 F.2d 1151 (5th Cir. 1985).

43 The district court held the agreement between the parties did not provide for the situation where the field ceased production while balances were outstanding. It ruled it implied a term to achieve an equitable result. The appeal court quoted the clause in the contract that provided for balancing payments: "To allow the recovery of gas in storage and to balance the gas account of the parties in accordance with their respective interests, . . . a party with gas in storage shall be entitled to take or deliver to a purchaser its current share of the gas produced . . . plus up to 25% of the other party's share of gas production . . . until such time as that quantity of gas in storage shall be reduced to zero." The court read the clause to be clear that cash payments were not required. *Id*. at 1154.

44 "A 'single purpose entity' 'is an entity, formed concurrently with or immediately prior to the subject transaction, that is unlikely to become insolvent as a result of its own activities and that is adequately insulated from the consequences of any related party's insolvency.'" U.S. CMBS Legal and Structured Finance Criteria, Standard & Poors, May 1, 2003, at 89. Quoted in Wells Fargo Bank, N.A. v. Cherryland Mall Ltd. Partnership, 295 Mich. App. 99, 812 N.W.2d 799, 810 (Mich. App. 2011); *remanded* 433 Mich. 859, 820 N.W.2d 901 (2012). In that case the borrower, formed to own a shopping mall and obtain an $8.7 million loan from a lender, covenanted to maintain its status as a single purpose entity, which required, inter alia, that it not become insolvent. In the event the borrower failed to maintain that status the lender was entitled to full recourse against the borrower and the guarantor. The borrower became insolvent because of downturn in the market and claimed its resulting insolvency was not covered by the clause. The court held the covenant "does not require insolvency to occur in any specific manner. Rather, any failure to remain solvent, no matter what the cause, is a violation." 295 Mich. App. 99, 125, 812 N.W.2d 799, 815.

45 981 F. Supp. 86 (S.D.N.Y. 1997).

46 *Id*. at 91.

47 "In the present case, the allocation of risk was especially appropriate because the System was essentially a prototype model, designed, manufactured and installed by [subcontractor] Tecogen, the value of which was substantially greater than the actual contract price." *Id*. at 101.

48 906 F.2d 158 (5th Cir. 1990).

49 *Id*. at 166.

50 *Id*. at 166.

51 The contractor claimed the releases unambiguously covered the claims for extra costs. The district court held the wording was ambiguous and did not release the contractor from claims for additional compensation due to delays in approving the subcontractor's shop drawings, because it acknowledged partial payments, five such releases were executed, and a complete release was inconsistent with the parties' intention as to payment of compensation for the delay. The court instructed the jury to decide if the releases covered the claims for additional compensation. The jury found the releases did not bar the subcontractor's recovery.