One of the classic justifications for the enforcement of liquidated damages clauses is the prospective inability to prove actual damages with reasonable certainty. Thus, the classical view made a liquidated damages clause constituting an honest and reasonable estimate of damages in the event of a breach enforceable. Section 2-718(1) of the Uniform Commercial Code made an important change in this requirement in contracts for the sale of goods that was replicated in Restatement (Second) of Contracts §356(1) for other types of contracts. It announced a much more flexible approach by stating that the amount in the liquidated damages clause must be reasonable “in the light of the anticipated or actual harm caused by the breach.” Under this “modern” view, liquidated damages clauses become enforceable if they are either prospectively reasonable with respect to anticipated harm (a “first look” or “single look” or “foresight” view) or retrospectively reasonable with respect to actual injury (“second look” or “hindsight” perspective).

The change was not without its critics. Early on, Professor (later Judge) Ellen Peters noted that the UCC “was unusually generous in the amount set by the contracting parties. Even if this amount was entirely unreasonable, as of the time of contract, it can apparently be recovered so long as it turns out, purely as a matter of accident, to approximate the harm actually caused by the breach.” E. Peters, Remedies for Breach of Contract Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two, 73 Yale L.J. 199, 278 (1963).

A correlative critical analysis is patently clear. Under the flexible view, a contract containing a liquidated damages amount that is clearly unforeseeable and intended as a penalty at the time the contract is formed can become enforceable through the sheer accident of unusual actual damages accidentally bearing a reasonable relation to the amount in the clause. The change, therefore, could support clear violations of the sacred rubric of Hadley v. Baxendale, 156 Eng. Rep. 145 (1854), which continues to be regarded as the critical “foreseeability” limitation on recoverable contract damages. Foreseeability is measured at the time the contract is formed. If a clause contains an amount for damages that is clearly unforeseeable but accidentally turns out to be a reasonable amount in relation to actual unforeseeable damages, the clause is enforced. At the time the contract was formed, the clause was clearly intended as a penalty. Thus, its enforcement also undermines the fundamental policy of refusing to enforce penalty
clauses since contract law is dedicated to reasonable compensation for losses suffered rather than punitive damages.

A countervailing policy justifying the more flexible approach may be discovered in cases of no actual injury under a clause containing an amount that is reasonable at the time the contract is formed. If contract law is designed to place an aggrieved party in the position that party would have been in had the contract been performed, allowing a recovery of liquidated damages when no actual harm has occurred allows a windfall that violates the purpose of contract law. On the other hand, the essential justification for enforcing the liquidated damages clause absent any actual injury is the avoidance of disputes over the fact and amount of actual injury, an argument that supports a return to the classic view of limiting enforceable clauses to those which are reasonable in terms of the educated guess made at the time the contract is formed.

Consider the case of Carrothers Constr. Co., LLC v. City of South Hutchinson, 39 Kan. App. 2d 703, 184 P.3d 943 (2008), aff'd, 207 P.3d 231 (Kan. 2009). On March 12, 2002, Carrothers Construction Company, LLC (Carrothers), agreed to construct a wastewater treatment facility for the City of South Hutchinson (City) at a contract price of $5,618,000. The contract included a liquidated damages clause of $850 for each day of delay. The City withheld $145,830 from its payment to Carrothers for 171 days of delay. Carrothers claimed that the liquidated damages clause was a penalty when viewed retrospectively, i.e., it did not bear a reasonable relationship to the actual damages sustained by the City. The trial court granted summary judgment for the City. The court of appeals discovered language in its precedent that required a consideration of either prospective damages or actual injury, but concluded that the clause was reasonable as to either.

On this appeal to the Supreme Court of Kansas, Carrothers cited Hutton Contracting Co. v. City of Coffeyville, 487 F.3d 772 (10th Cir. 2007), a Tenth Circuit case applying Kansas law, in claiming that, though the clause may have been reasonable in terms of anticipated harm, the amount in the clause had to be reasonable both prospectively and retrospectively - a “two hurdle” test. Carrothers argued that it was unreasonable in terms of actual harm to the City. Thus, it claimed that the second hurdle to an enforceable clause had not been cleared.

The Supreme Court stated that Carrothers was “wrong” in its analysis of Hutton Contracting because that opinion expressly indicated that Kansas had not definitely an-
answered the question of whether Kansas law would adopt a “single look” or “second look” approach. The Court proceeded to provide a definite answer:

“To the extent any prior decisions of our Court of Appeals have contributed to that doubt by adding a retrospective test in their determination of this issue, they are overruled as to this limited point." 207 P.3d 243.

The Court explained that the imposition of a “two hurdle” test would deny the parties' obvious intent as well as denying the City the benefit of its bargain. A “second look” at actual damages undermines the very purpose of an agreement designed to allow parties to include a reasonable estimate of probable damages in situations where actual damages are difficult to ascertain prospectively. Though its holding was in obvious disagreement with the flexible approach in Restatement (Second) of Contracts §356(1), the Court quoted Comment a of that section: a reasonable liquidated damages clause “saves the time of courts, juries, parties and witnesses and reduces the expense of litigation.”

A similar analysis underlies the earlier return to the classical view in Kelly v. Marx, 428 Mass. 877, 705 N.E.2d 1114 (1999). In Kelly, the plaintiffs agreed to purchase the defendant’s real property for $355,000 under a contract allowing the seller to retain a five percent down payment as liquidated damages. When the plaintiffs breached, they claimed they were entitled to the return of their down payment because there was no actual injury. The property was sold to another for $360,000 two weeks after the plaintiffs' repudiation of the contract. The trial court granted the defendant seller's motion for summary judgment, but the court of appeals reversed on the footing that the retention of the down payment was a penalty when compared to actual injury, of which there was none. Massachusetts precedent included Shapiro v Grindstone, 27 Mass. App. Ct. 596, 541 N.E.2d 359 (1989), which adopted a retrospective approach consistent with Restatement (Second) of Contracts §356. The Supreme Judicial Court of Massachusetts, however, reversed the court of appeals by rejecting a “second look” approach on the footing that an exclusive “first look” approach resolves disputes efficiently by making it unnecessary for a trial and other costly litigation to determine actual damages. An exclusive “first look” (“single look”) approach fulfills the reasonable expectations of the parties.

The Court also discussed the reliance by the Shapiro court on Restatement (Second) of Contracts §356 and illustration 4 of that section, in which a delay in constructing a race track grandstand resulted in no actual loss. The illustration concludes that, since the actual loss was not difficult to prove, the liquidated damages clause constituted a penalty that was unenforceable. The Court concluded that the illustration contradicts the ex-
press language of § 356(1), which permits the enforcement of a clause that is reason-
able in the light of anticipated or actual loss.

There has been a split of authority concerning the prospective (“first” or “single” look) approach versus the “first” and “second” (“hindsight”) approach. The court of appeals in 
Kelly v. Marx, **44 Mass. App. Ct. 825, 732-833**, 694 N.E.2d 869, 873-874 (1998), lists the cases and statutes suggesting different views. The flexible rule of the Restatement (Second) should not be viewed as a “two hurdle” approach that requires the clause to be reasonable in light of anticipated harm and actual loss. The rule in §356(1) is stated in the disjunctive: “reasonable in the light of the anticipated or actual breach caused by the loss.” Thus, the *Kelly v. Marx* criticism of illustration 4 of that section is well taken.

It is important to recognize that, distinctions between “first look” and “second” or “single look” jurisdictions may not be clear. Cases that disallow liquidated damages where there is no ac-
tual loss may not necessarily suggest a “second look” approach. Rather, they may treat the total absence of actual loss as such an aberration that it constitutes a very limited exception to an otherwise “single look” approach. In such jurisdictions, if actual damages have been suffered, albeit much smaller in amount than the amount specified in an otherwise prospectively reasonable liquidated damages clause, the clause will be enforced because it meets the “single look” test of reasonableness when compared to anticipated harm.

The choice of a “single look” or prospective approach is not possible under the Uniform Commercial Code. Even where the classic single look approach has been clearly adopted, it will not apply to liquidated damages clauses in contracts for the sale of goods governed by Article 2 of the Code where §2-718(1) will allow a clause to be en-

**For additional discussion and analysis on liquidated damages, see Corbin on Contracts § 58**

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