UCC 2-718(1): Attorney's Fees as Liquidated Damages In New York

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NOTES AND COMMENTS

UCC 2-718(1): ATTORNEY’S FEES AS LIQUIDATED DAMAGES IN NEW YORK

INTRODUCTION

“Liquidated damages constitute the compensation which, the parties have agreed, must be paid in satisfaction of the loss or injury which will follow from a breach of contract.” The stipulated amount will be given legal effect, provided it is predicated upon the doctrine of just compensation for the harm caused by the breach. Where, however, the sum stipulated is unreasonably large, or is designed to secure or coerce a party’s performance under the contract, the provision will be deemed a penalty, and considered void.


4 See, e.g., Jarro Bldg. Indus. Corp. v. Schwartz, 54 Misc. 2d 13, 281 N.Y.S.2d 420 (App. T. 2d Dep’t 1967) (liquidated damages provision which also gave aggrieved party the right to sue for damages void as attempt to secure performance). See also Brightman, supra note 1, at 277.

5 See Sweet, Liquidated Damages in California, 60 Calif. L. Rev. 84, 92 (1972) [hereinafter cited as Sweet].

A penalty has been defined as a sum named, which is disproportionate to the damage which could have been anticipated from breach of the contract, and which is agreed upon in order to enforce performance of the main purpose of the contract by the compulsion of this very disproportion. It is held in terrorem over the promisor to deter him from breaking his promise.

5 WILLISTON, supra note 1, § 776, at 668 (footnote omitted). See generally Sweet, supra note 5, at 92. But see 5 CORBIN, supra note 2, § 1058, at 340, where the author contends that often a valid liquidated damages provision is also utilized in an in terrorem capacity.
The onus thus falls upon the judiciary to determine whether a stipulation is an enforceable liquidated damages provision, or an unenforceable penalty. Over 100 years ago, Judge Miller of the New York Court of Appeals was compelled to remark that this burden "is one of considerable difficulty, and the authorities on the subject are replete with contradictions."

In contrast to the uncertainty concerning the enforceability of liquidated damages provisions, the question whether attorney’s fees are recoverable as an element of damages in a lawsuit has long been settled in New York. Considered to be merely incidents of litigation, attorney’s fees are not normally recoverable absent specific statutory authority or contractual agreement.

In *Equitable Lumber Corp. v. IPA Land Development Corp.*, the New York Court of Appeals, departing significantly from prior interpretation, characterized a contractual agreement to pay attorney’s fees as a stipulation for liquidated damages. This Note will examine the court’s decision and attempt to discern its import.

**Equitable Lumber Corp. v. IPA Land Development Corp.**

The *Equitable Lumber* defendant, a builder and developer, entered into an agreement to purchase a quantity of lumber and building supplies from the plaintiff, a lumber company. One of the clauses in the contract, provided:

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12 See notes 127-29 and accompanying text infra.

13 Directly above the space reserved for the signatures of the parties, the agreement, prepared by the plaintiff, conspicuously stated: "THE TERMS AND CONDITIONS SET FORTH ON THE REVERSE SIDE HEREOF ARE EXPRESSLY MADE A PART OF THIS AGREEMENT." 38 N.Y.2d at 518 n.2, 344 N.E.2d at 393 n.2, 381 N.Y.S.2d at 461 n.2. The contract was executed by the presidents of the respective corporations. Brief for Appellant at 3, A-20.
If the Buyer breaches this contract and the enforcement thereof, or any provision thereof, or the collection of any monies due thereunder is turned over to an attorney, the Buyer herein agrees to pay, in addition to all of Seller's expenses, a reasonable counsel fee; and in the event the matter turned over is the collection of monies, such reasonable counsel fee is hereby agreed to be thirty (30%) per cent. The guarantor shall also be liable for such counsel fee and expenses.\textsuperscript{14}

The plaintiff thereafter delivered the materials specified in the contract, but the defendant refused to pay for them.\textsuperscript{15} The plaintiff then instituted suit for recovery of the purchase price of the materials supplied, together with the attorney's fees provided for in the contract.\textsuperscript{16}

Upon plaintiff's motion for summary judgment, the Supreme Court, Kings County, awarded the plaintiff $3936.42, representing the balance due on the materials delivered. Additionally, the court determined that the defendant was liable for the plaintiff's attorney's fees, but refused to enforce the thirty percent provision of the contract.\textsuperscript{17} Instead, the court conducted a hearing to ascertain the nature and extent of the services rendered by the plaintiff's attorney\textsuperscript{18} and determined that no more than 10 hours were necessary for the attorney to handle the matter adequately, and fixed attorney's fees at $450.\textsuperscript{19} On appeal, the Appellate Division, Second Department modified the award in a brief memorandum opinion, increasing the attorney's fees to $750.\textsuperscript{20} Seeking to have the thirty percent stipulation strictly enforced, the plaintiff appealed the decision to the court of appeals.

Writing for a unanimous court, Judge Gabrielli reversed the order of the appellate division, concluding that the approach employed by the supreme court in construing the provision for attor-
ney's fees was incorrect. The court determined that the stipulation was an agreement for liquidated damages, and analyzed it under section 2-718(1) of the Uniform Commercial Code (UCC), the provision applicable to liquidated damages in transactions involving the sale of goods. To understand fully the court's decision, however, it is necessary initially to independently examine the law concerning liquidated damages stipulations and the law concerning attorney's fees provisions in New York.

LIQUIDATED DAMAGES

At early common law, "penal bonds" were commonly exacted to secure the performance of obligations. A sum of money, often in excess of the value of the principal obligation, was stipulated to be paid by the debtor in the event of default. If the obligation was faithfully performed, the promise to pay this penal sum was considered void. In an action upon the bond, the common law courts would enforce, as a matter of course, the penalty in addition to the principal obligation. Equity soon intervened, however, and prevented recovery of any sum in excess of the principal obligation.

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21 N.Y.U.C.C. § 2-718(1) (McKinney 1964) states:
Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

22 Penal bond obligations are derived from the poenae stipulatio, the conventional penalty of ancient Roman law which allowed the recovery of a penal sum upon default in the performance of an obligation. The poena was strictly enforced, even if it exceeded the value of the principal obligation. Depending upon the circumstances, the penalty was considered to operate either as indemnification for the harm occasioned by the breach, or as a substitute for the damages suffered by the promisee. See Loyd, Penalties and Forfeitures, 29 Harv. L. Rev. 117 (1915) [hereinafter cited as Loyd]; Comment, Penal Clauses and Liquidated Damages, A Comparative Study, 33 Tul. L. Rev. 180, 181 (1958) [hereinafter cited as Comparative Study].

23 See 5 CORBIN, supra note 2, § 1056, at 321; McCormick, supra note 1, at 104-05. Although the primary purpose of the stipulated sum may have been to punish breach or coerce performance, it was not thereby rendered unenforceable. 2 PAGE, supra note 7, § 1169, at 1795.

24 McCormick, supra note 1, at 104-05.

25 See Sun Printing & Publishing Ass'n v. Moore, 183 U.S. 642, 660 (1902); Watts v. Camors, 115 U.S. 353, 360 (1885). The penalty was strictly enforced according to its terms. 2 PAGE, supra note 7, § 1169, at 1794-95; Comparative Study, supra note 22, at 184.

26 See Watts v. Camors, 115 U.S. 353, 360-61 (1885). One authority has declared: "Equity . . . looked at the intent and not the outward form or the contract, and relieved against penalties and forfeitures." 2 PAGE, supra note 7, § 1169, at 1795 (footnote omitted). Equity's prohibition against penalties extended beyond the disallowance of penal sums in bonds. For example, the forfeiture of land conveyed in a mortgage upon default by the mortgagor was
Subsequently, the same result was mandated in law by statutes that limited a plaintiff’s recovery to the actual damages suffered from the breach of the obligation.\textsuperscript{27} These principles, evolved in actions upon bonds, subsequently were extended to all contracts.\textsuperscript{28}

Although the courts had determined not to enforce penalty provisions, contractual agreements to liquidate damages soon became judicially acceptable, for “it came to be recognized that promises to pay money as recompense for future defaults which could not be exactly valued, were legitimate expedients for avoiding the uncertainty of a jury’s finding and should be enforced.”\textsuperscript{29}

In evaluating a liquidated damages provision, the common law courts generally focused upon three principal areas of inquiry: First, the intention of the parties;\textsuperscript{30} second, the difficulty of ascertaining damages upon breach;\textsuperscript{31} and third, the reasonableness of the amount stipulated.\textsuperscript{32}

\textit{The Intention of the Parties Requirement}

In \textit{Cotheal v. Talmage},\textsuperscript{33} the court of appeals expressed the subsequently oft-stated rule\textsuperscript{34} that “courts are to be governed by

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\textsuperscript{27} See 8 & 9 Wm. 3, c. 11, § 8 (1697); 4 Anne, c. 16, §§ 12-13 (1705), \textit{discussed in Loyd, supra} note 22, at 126. In essence, such statutes provided that “the plaintiff in actions upon penal bonds should state the breaches of the condition, and, although entitled to judgment for the amount of the penalty, should be limited in his recovery to the damages proved, the judgment merely remaining as security for further breaches.” \textit{Id.} at 126. These concepts have subsequently been incorporated into our modern law. 5 \textit{Williston, supra} note 1, § 775A, at 658. Today, “the rule is universal that the measure of damages upon a bond with penalty is the plaintiff’s actual damage from the breach of condition.” McCormick, \textit{supra} note 1, at 106. \textit{See generally 2 Page, supra} note 7, § 1169, at 1795-96; 1 \textit{Sedgwick, supra} note 2, § 390, at 758.

\textsuperscript{28} See 5 \textit{Williston, supra} note 1, § 776, at 667; \textit{Comparative Study, supra} note 22, at 185.


\textsuperscript{30} \textit{See notes 33-43 and accompanying text infra.}

\textsuperscript{31} \textit{See notes 44-57 and accompanying text infra.}

\textsuperscript{32} \textit{See notes 58-69 and accompanying text infra.}

\textsuperscript{33} 9 N.Y. 551 (1854).

[the] intention of the parties, to be gathered from the language of the contract and from the nature and circumstances of the case," in determining whether a provision is an enforceable liquidated damages stipulation or an unenforceable penalty. If the court finds that the parties intended the sum to operate as liquidated damages, the provision must be enforced, for "the courts are not authorized . . . to make a new contract for the parties, or unmake the one made by them . . . ." Although some courts have held that the language used in the contract is determinative of the provision's characterization, most

25 9 N.Y. at 554.
26 The intention of the parties test has been considered by some courts to be "the fundamental rule" in construing a stipulation for liquidated damages. See, e.g., Kemp v. Knickerbocker Ice Co., 69 N.Y. 45, 58 (1877). But see notes 41-43 and accompanying text infra.
27 Clement v. Cash, 21 N.Y. 253, 256 (1860). In an early leading case, Dakin v. Williams, 17 Wend. 447 (N.Y. Sup. Ct. of Jud. 1837), aff'd, 22 Wend. 447, aff'd, 22 Wend. 201 (N.Y. Ct. of Errors 1839), the plaintiffs agreed to purchase the defendant's newspaper plant and subscription list for $3500. As additional consideration, the parties covenanted that the defendant would pay $3000 to the plaintiffs as liquidated damages if the defendant should ever venture into the newspaper industry again or give assistance to a competing paper. Upon breach of the agreement, the plaintiffs sued for the stipulated amount. In holding that payment of the sum was enforceable, the court remarked that the business of the court . . . is to inquire after the meaning and intent of the parties; and when that is clearly ascertained from the terms and language used, it must be carried into effect. . . . If [the parties] are competent to contract within the prudential rules the law has fixed as to parties, and there has been no fraud, circumvention or illegality in the case, the court is bound to enforce the agreement.
17 Wend. at 454.

Other courts have similarly acknowledged a "duty" to enforce a liquidated damages provision once the intention of the parties has been affirmatively ascertained. See, e.g., United States v. Bethlehem Steel Co., 205 U.S. 105, 119 (1907); Sun Printing & Publishing Ass'n v. Moore, 183 U.S. 642, 662 (1902). Once the court has determined that the stipulation was intended to operate as liquidated damages, the sum must be enforced, for a court cannot refuse to enforce a stipulation merely because it might feel that one of the parties entered into a poor bargain. See, e.g., Couch v. Newtown Council Bldg. Ass'n, 109 App. Div. 856, 96 N.Y.S. 441 (2d Dep't 1905). When the intention of the parties is in doubt, however, the tendency of the courts "is to favor the construction which makes the sum payable for breach of contract a penalty rather than liquidated damages . . . ." City of New York v. Brooklyn & Manhattan Ferry Co., 238 N.Y. 52, 56, 143 N.E. 788, 790 (1924). Accord, Associated Gen. Contractors, Inc. v. Savin Bros., 45 App. Div. 2d 53, 356 N.Y.S.2d 374 (3d Dep't 1974), aff'd per curiam, 36 N.Y.2d 957, 335 N.E.2d 859, 373 N.Y.S.2d 555 (1975); J. Weinstein & Sons v. City of New York, 284 App. Div. 398, 55 N.Y.S.2d 530 (1st Dep't), aff'd mem., 289 N.Y. 741, 46 N.E.2d 351 (1942). See generally 2 PAGE, supra note 7, § 1173, at 1800.
28 See, e.g., Clement v. Cash, 21 N.Y. 253, 256-57 (1860). In Callanan Rd. Improvement Co. v. Colonial Sand & Stone Co., 190 Misc. 418, 72 N.Y.S.2d 194 (Sup. Ct. Albany County 1947), the plaintiff, a manufacturer of crushed stone, sued the defendant buyer for breach of contract. The parties had agreed that the defendant would pay a specified amount, expressly labeled as liquidated damages, in the event that the defendant should breach the agreement by taking less than the minimum quantity of stone stated in the contract. In holding that the stipulated damages were recoverable by the plaintiff, the court seized upon the language
courts construing a stipulation have declined to be constrained by the parties' choice of terminology. As a result, it appears that what the parties "intended" often depends ultimately upon the construction given to the provision by the court: If the court decides to enforce the stipulation, the parties are said to have "intended" the clause to be a liquidated damages provision; if the court refuses to enforce it, the parties are therefore said to have "intended" a penalty. Consequently, the intention of the parties test has been severely criticized, being characterized as both irrelevant and not controlling.

Professor Corbin notes that the characterization chosen by the parties normally has little influence upon the court's construction of the provision. See generally Liquidated Damages in Illinois Contracts, supra note 8, at 187.

In construing the intention of the parties, "[t]he intent involved . . . is 'legal intent,' which may be entirely different from the actual intention present in the minds of the contracting parties." Anderson, Liquidated Damage Problems in Construction Contracts, 5 PRAC. LAW., Feb. 1959, at 73 [hereinafter cited as Anderson]. See also Arndt, Liquidated Damages in California, 10 CALIF. L. REV. 8, 13 (1921), where the author notes that the parties' actual intention may be different from the court's construction of their intention.

In Little v. Banks, 85 N.Y. 258 (1881), for example, it was only after holding the liquidated damages stipulation to be enforceable, that the court declared that the parties had intended the sum to operate as liquidated damages and not as a penalty.

Professor Williston maintains: "'Intention of the parties' is . . . a misleading and undesirable designation . . ., and the first step towards clearing the confusion of the law on the subject [of liquidated damages] is to drop the use of that phrase from the discussion." 5 WILISTON, supra note 1, § 778, at 693 (footnote omitted).

"Rarely is there any doubt about what the parties intended. If the agreement is to the effect that if A fails to perform as promised he shall pay Y dollars to B, that is what they meant. What is there to construe?"

The true rule surely is that the intention of the parties . . . is irrelevant; that the law, as a matter of public policy, imposes a limitation upon the freedom of the power to contract, and that if a contractual provision is not within the limitation it is invalid.

Id. at 225 (footnote omitted).

See, e.g., Jacob Glass, Inc. v. Banca Marmorosch, 122 Misc. 637, 639, 204 N.Y.S. 636,
The Difficulty of Ascertainment Requirement

Perhaps the critical test in determining the validity of a liquidated damages provision is whether the damages would be difficult or incapable of ascertainment upon breach. In *Ward v. Hudson River Building Co.*, an early leading case, the plaintiff, a contractor, agreed to erect certain houses for the defendant. The agreement provided for the sum of $10 per day to be assessed against the contractor in the event he delayed completing the structures. Holding that the contractual term was an enforceable liquidated damages provision, the New York Court of Appeals stated the following rule:

> If it shall . . . appear that the damage and loss, which may be presumed to result from nonperformance, are uncertain and incapable of exact ascertainment, then the payment or liability fixed by [the parties] must be deemed to be liquidated damages and recoverable as such.

The rationale for this rule was illuminated in the subsequent case of *Curtis v. Van Bergh*, which involved an agreement to erect and lease a building. In *Curtis*, the parties had agreed upon liquidated damages of $50 per day should the plaintiff fail to complete the structure on time. Subsequently, when occupancy was post-poned because of the builder's delays, the lessee sought to implement the liquidated damages provision. In reversing a judgment for the builder, the court of appeals stated: "We thus reach the ultimate question, whether the damages within the contemplation of the parties when they made the contract in question, are so uncertain as to be difficult of ascertainment . . . ."

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637 (N.Y.C. City Ct. 1924); Prentice, supra note 8, at 879. But see Liquidated Damages in Illinois Contracts, supra note 8, at 186 (intention of the parties considered a controlling factor); Comment, *A Functional Approach in Determining the Validity of a Liquidated-Damages Clause*, 30 Tex. L. Rev. 752, 760 (1952) [hereinafter cited as *Functional Approach*] (intention of the parties test will continue to be used by the courts as a tool). Some commentators contend that the ultimate factor in construing the intention of the parties is whether there is a reasonable relationship between the sum stipulated and the damages to be anticipated upon breach. See 5 Coari, supra note 2, § 1058, at 340; McCormick, supra note 1, at 111-12; Prentice, supra note 8, at 881.

*[1] See Sweet, supra note 5, at 131. But see Prentice, supra note 8, at 885, where the author suggests that the ascertainment test should be abandoned.


*[3] Id. at 235, 26 N.E. at 257 (emphasis added).


*[5] The plaintiff contended that since the rental to be paid by the defendant upon occupancy was only $5.75 per day, the $50 per day liquidated damages provision was therefore unconscionable and void as a penalty. Id. at 52, 55 N.E. at 400.

*[6] Id.*
The court answered this decisive question in the affirmative, noting the particular circumstances which had rendered the damages difficult to ascertain: the lessee's manufacturing business would have been appreciably disrupted if the building was not promptly completed; its fall and winter goods could not have been manufactured; and it would have had to either hold over in its prior location and face possible eviction or suffer the trouble and expense of moving twice if it could secure another building. Since these elements of damage were wholly conjectural at the time the contract was negotiated, and were incapable of accurate assessment upon breach, the liquidated damages provision was sustained.

Certain courts and commentators appear to have employed a different test in lieu of the difficulty of ascertainment test, asking instead whether the damages incident to a breach are "incapable of

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20 See note 61 and accompanying text infra.

21 An examination of some of the leading cases reveals the importance ascribed to the ascertainment test when evaluating a stipulation for liquidated damages. Thus, in Edelstein v. Spielberger, 197 App. Div. 262, 188 N.Y.S. 723 (1st Dep't 1921), the defendant agreed to purchase shares of stock from the plaintiff for $10,750 to be paid in installments. The contract provided that if the defendant defaulted on any payments, the plaintiff could retain the monies already paid, in addition to the stock, as liquidated damages. After payments were made totalling $5000, the defendant defaulted. The plaintiff sued for the balance of payments yet outstanding, $5750. The defendant alleged that the plaintiff's recovery was limited by the agreement to any amounts already paid. In affirming a judgment for the plaintiff, Judge Page answered the defendant's allegation:

It is true that the agreement so provides, but the parties to a contract can only provide for the liquidation of damages in case the damages are uncertain, speculative or difficult of computation, and where the contract calls for the sale of personal property, payment to be made in installments, and certain installments are paid on account, and the defendant defaults on subsequent payments, the damages are certain and liquidated by law. It is not necessary or proper for the parties to provide for the forfeiture of the amount already paid as liquidated damages. The damages in this case are certain and capable of exact computation and are not speculative.

Id. at 264, 188 N.Y.S. at 724-25 (emphasis added).

Similarly, in Caesar v. Rubinson, 174 N.Y. 492, 67 N.E. 58 (1903), the court, in holding a stipulated amount to be a penalty, stated:

There is no inherent difficulty in measuring the legal damages which the landlord sustained in a case where the tenant omits to pay the rent, and is for that reason dispossessed. . . . This is, therefore, a case where the damages sustained by reason of the breach of the lease . . . could have been easily ascertained . . .

Id. at 497, 67 N.E. at 60. See also Mosler Safe Co. v. Maiden Lane Safe Deposit Co., 199 N.Y. 479, 93 N.E. 81 (1910); Dunn v. Morgenthal, 73 App. Div. 147, 76 N.Y.S. 827 (1st Dep't 1902), aff'd mem., 175 N.Y. 518, 67 N.E. 1081 (1903); Jacob Glass, Inc. v. Banca Marmorosch, 122 Misc. 637, 204 N.Y.S. 636 (N.Y.C. City Ct. 1924); 1 SEDGWICK, supra note 2, § 393, at 760.

The Supreme Court has also endorsed the ascertainment test. See Priebe & Sons v. United States, 332 U.S. 407, 411 (1947) (Douglas, J.). But see 2 PAGE, supra note 7, § 1175, at 1803. For discussion of the ascertainment test, see generally 1 SEDGWICK, supra note 2, § 393, at 760; Anderson, supra note 40, at 73; Functional Approach, supra note 43, at 761-62.
estimation." Under this test, "it is necessary that at the time the contract is made it must appear that the injury that will be caused by the breach will be difficult of estimation." It is submitted that there is a crucial distinction between these two tests. Under the estimation test, it appears that only the prospective uncertainty of damages is considered. Under the ascertainment test, however, the damages, in addition to being conjectural, must be such that a court could not easily determine them upon breach. The New York courts, with but one exception, have clearly adopted the difficulty of ascertainment test.


53 5 CORBIN, supra note 2, § 1060, at 350 (footnote omitted). See generally Macneil, supra note 52, at 502.

54 The estimation test has been variously construed, sometimes even being used interchangeably with the ascertainment test. See Macneil, supra note 52, at 502.

55 There is a divergence of opinion concerning the proper vantage point for applying the ascertainment test. In Better Food Markets, Inc. v. American Dist. Tel. Co., 40 Cal. 2d 179, 253 P.2d 10 (1953), the court, in construing a California statute which codifies the ascertainment test, held that this test is to be applied as of the time when the contract was entered into, and not as of the time of its breach. For a discussion of the opinion, see Smith, Contractual Controls of Damages in Commercial Transactions, 12 HASTINGS L.J. 122, 123 (1960). Professor Sweet has criticized this decision, because actual damages could have been determined at trial without significant difficulty. He suggests that the difficulty of ascertaining damages be judged as of the time of the trial, thus avoiding the "potential unjust enrichment and the seeming injustice of enforcing a clause when actual damages are much different from the liquidated sum." Sweet, supra note 5, at 131-33.

The New York courts appear to follow Professor Sweet's suggestion, for although a liquidated damages provision is interpreted in New York as of the date when the contract was negotiated, and not as of its breach, see note 61 and accompanying text infra, the courts will still inquire into the situation at the time of breach. See, e.g., Seidlitz v. Auerbach, 230 N.Y. 167, 129 N.E. 461 (1920). But see Anderson, supra note 40, at 73.


The Reasonable Stipulation Requirement

Even if the damages are incapable of ascertainment, for a liquidated damages provision to be enforceable the sum stipulated by the parties must also be reasonable in amount.\(^5\) It must be "a genuine pre-estimate by the parties of the extent of injury that will be caused by a future breach of the contract,"\(^5\) and must not be a sum "grossly disproportionate to the anticipated probable harm ... ."\(^6\)

The general method utilized to determine the validity of a liquidated damages clause is to examine the provision as of the date of the contract, rather than as of its breach.\(^6\) Thus, most courts have assessed the reasonableness of the amount stipulated in rela-

\(^{5}\) As early as 1860, the New York Court of Appeals observed:

When . . . the damages resulting from the breach are uncertain in amount . . . the parties have the right to say how much shall be paid by way of compensation to the party injured; and when they have settled that compensation, neither a court of law nor a court of equity will diminish its amount, unless it be so grossly disproportionate to the actual injury that a man would start at the bare mention of it. Clement v. Cash, 21 N.Y. 253, 256 (1860) (emphasis added). See also Norris v. McMechen, 135 Misc. 361, 364, 238 N.Y.S. 181, 186 (Sup. Ct. Warren County 1930) (stipulated sum is enforceable unless it is so extreme that it shocks "the moral sense"). The reasonableness requirement has been unanimously endorsed by the commentators. See, e.g., 5 WILLISTON, supra note 1, § 779, at 695-99; Anderson, supra note 40, at 73; Liquidated Damages in Illinois Contracts, supra note 8, at 187-88.


Some courts have held that the burden of proving a stipulated sum to be so unreasonably large as to constitute a penalty is on the party seeking to repudiate the contract. See, e.g., Knoblauch v. Little Falls Dairy Co., 241 App. Div. 910, 272 N.Y.S. 31 (4th Dep't 1934) (mem.); Perma-Stone Bi-County Corp. v. Ackerman, 15 Misc. 2d 640, 182 N.Y.S. 655 (Sup. Ct. Kings County), aff'd mem., 8 App. Div. 2d 731, 187 N.Y.S.2d 991 (2d Dep't 1959).

tion to the anticipated probable damages. Some courts, however, have inquired into the relationship between the amount stipulated and the actual damages suffered upon breach. A few courts have deemed it appropriate to consider both probable and actual damages.

The judicial uncertainty in this area was exemplified in the recent case of *City of Rye v. Public Service Mutual Insurance Co.*, in which the plaintiff city instituted an action to recover a $100,000 bond given by the defendant as security for the timely construction of six buildings. The agreement between the parties provided for liquidated damages of $200 per day for each day completion was overdue. Subsequently, the defendant delayed completion for more than 500 days. In affirming the appellate division's denial of plaintiff's motion for summary judgment, the court of appeals initially stated the rule that "a provision fixing the damages in advance will be upheld if the amount is a reasonable measure of the anticipated probable harm." Yet, in a later portion of the opinion, the court

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It has long been the rule in this State that if the damage presumed to result from nonperformance of a contract is uncertain and incapable of exact ascertainment, the sum fixed by the parties is deemed to be liquidated damages and is recoverable as such, unless the sum stipulated to be paid by the defaulting party is, when interpreted as of the date of the agreement, grossly disproportionate to the presumable or probable damage, or to the readily ascertainable loss.

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47 Id. at 473, 315 N.E.2d at 459, 358 N.Y.S.2d at 393 (emphasis added).
also stated that "[t]here is nothing to show that either the sum of $200 per day or the aggregate amount of the bond bear any reasonable relationship to the pecuniary harm likely to be suffered or in fact suffered."

Should the court ultimately hold a stipulation to be a penalty, actual damages do become vitally important. In such a case, the rule is firmly established that the stipulation is considered void, and the party seeking to enforce the provision may nonetheless recover such actual damages as he can prove.

In sum, the common law requirements essential for a valid liquidated damages provision are that the stipulated sum must be reasonable in amount, and that the damages, as of the time of contracting, must be difficult to ascertain upon breach. It is submitted that the intention of the parties test, although frequently discussed in the older cases, no longer can be considered a vital prerequisite.

LIQUIDATED DAMAGES UNDER THE UCC

Section 2-718(1) of the UCC provides:

Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the

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67 Id., 315 N.E.2d at 459, 358 N.Y.S.2d at 394 (emphasis added). Similarly, in Weatherproof Improvement Contracting Corp. v. Kramer, 12 Misc. 2d 100, 172 N.Y.S.2d 688 (N.Y.C. Mun. Ct. Bronx County 1956), plaintiffs initiated suit to recover liquidated damages of $600 for the breach of a contract to repair their home. The agreement executed by the parties had fixed liquidated damages at 30% of the contract price, while also giving the plaintiffs the option to sue at law for damages. In dismissing the complaint, the court first stated that "liquidated damages must be reasonable and not disproportionate to the probable damages . . . ." Id. at 103, 172 N.Y.S.2d at 691 (emphasis added). However, as part of the rationale, the court later remarked that it was not satisfied "that there is no great disparity between the actual damage and the agreed damage." Id. at 105, 172 N.Y.S.2d at 693 (emphasis added). But see Konner Rental Corp. v. Pedone, 50 Misc. 2d 69, 269 N.Y.S.2d 463 (Sup. Ct. Nassau County 1966), wherein the court observed that the stipulated amount must be enforced even if the actual damages are much less than the liquidated sum.

68 One commentator has stated: "If a provision specifying a payment by the promisee upon breach of his covenant is held to be invalid as constituting a penalty, the legal effect is as though it were expunged from the contract." Dunbar, supra note 42, at 227. See note 7 and accompanying text supra.

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.  

There is substantial disagreement among courts and commentators as to the effect of section 2-718(1) upon pre-Code case law. One school of thought contends that this section does not alter the common law on liquidated damages, while the other school suggests that the Code significantly changes prior law.

Under the former view, section 2-718(1) is considered to be merely a codification of pre-Code law. Proponents of this theory regard section 2-718(1) as a derivative of section 339 of the first Restatement of Contracts, which provided in pertinent part:

(1) An agreement, made in advance of breach, fixing the damages therefor, is not enforceable as a contract and does not affect the damages recoverable for the breach, unless (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.

The other school, however, asserts that section 2-718(1) is more liberal than the pre-Code law because of the inclusion of the so-called "actual harm" test. Whereas the common law determined

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22 See, e.g., Jones, Remedies Under Article 2, 30 Mo. L. Rev. 212, 222 (1965), wherein the author contends that § 2-718(1) is not substantially different from § 339 of the Restatement of Contracts.
23 Restatement of Contracts § 339(1)(a), (b) (1932).
the validity of a liquidated damages provision solely on the basis of the anticipated probable harm, section 2-718(1) expressly provides that should the stipulation fail the anticipated harm test, it must then be assessed in light of the actual damages suffered upon breach. Thus, "[e]ven if [the] amount was entirely unreasonable, as of the time of the contract, it can apparently be recovered so long as it turns out... to approximate the harm actually caused by the... breach."

The opposing schools can perhaps be reconciled by noting that the actual harm test, although a deviation from the strict common law construction of liquidated damages, simply codifies the aforementioned practice employed by some courts of comparing the stipulated amount with the actual damages suffered. Nevertheless, it is clear that section 2-718(1) sanctions a dual approach for determining the reasonableness of a liquidated damages provision, instructing the court to consider both anticipated and actual harm.

In addition, the section also dictates that the court must weigh "the difficulties of proof of loss" and "the inconvenience or nonfeasibility

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\(^7^a\) See note 62 and accompanying text supra. But see notes 63 \& 64 and accompanying text supra.

\(^7^b\) See N.Y.U.C.C. § 2-718(1) (McKinney 1964). The New York Law Revision Commission expressed difficulty in construing the alternative tests of anticipated and actual harm:

Will either anticipated or actual harm corresponding to the liquidated damages validate the agreement? Or will a clause which was reasonably related to anticipated harm be invalidated if it is out of line with the damage which actually occurred? The proper construction is doubtful, and the Comments shed no light. Probably the better construction is the first, so that if actual harm is in line with the stipulated sum, it will not be necessary to speculate concerning the parties' anticipations.

1 LAW REVISION COMM'N, supra note 75, at 247 (emphasis in original) (footnote omitted).

\(^7^c\) Peters, supra note 75, at 278. Dean Hawkland adds that

a stipulation of damages that is reasonably related to the anticipated harm at the time of the stipulation, is not necessarily invalidated because it fails to forecast correctly the damages that were actually suffered. Conversely, even if the stipulation of damages does not reasonably reflect a fair judgment of anticipated harm as of the time of its making, it is validated by events that put it in line with the damages which actually occur.


\(^7^d\) See Note, Limitations on Freedom to Modify Contract Remedies, 72 YALE L.J. 723, 751 (1963), in which it is contended that by means of the actual harm test, § 2-718(1) "recognizes... what the courts actually do... ." (emphasis added).

of otherwise obtaining an adequate remedy." Thus, section 2-718(1) provides a tripartite test to assess the reasonableness of a stipulation for liquidated damages.

The "difficulties of proof of loss" test is but a codification of the common law "difficultly of ascertainment" test. As Dean Hawkland notes,

[the difficulties of proof test] always has been recognized as a principal justification for the use of a liquidated damages clause. Without this justification, the clause fails of its essential purpose, and, in this event, there is no reason to utilize it instead of the normal remedies for damages provided by law.

Another commentator adds that "[s]ection 2-718 . . . will not protect the clause unless it approximates injury under circumstances in which post-breach assessment of damages is difficult."

The third criterion of reasonableness, "the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy," is difficult to understand. It has been suggested that this test is merely illustrative of the "difficulties of proof of loss" test. As such, if it is "clear that an adequate remedy is conveniently and feasibly available, [an otherwise valid liquidated damages] provision becomes an unreasonable one" and is therefore unenforceable.

The case law applying section 2-718(1) has appropriately been described as "sparse and inconclusive." In Mellor v. Budget Advi-

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81 Uniform Commercial Code § 2-718(1).
82 See 1 Law Revision Comm'n, supra note 75, at 247. But see 3A Duesenberg & King, supra note 74, § 14.08, at 14-64; Comment, Buyer's Remedies in Sales Cases Under the Uniform Commercial Code, 2 Land & Water L. Rev. 419, 442 (1967) (tests under § 2-718(1) are to be construed in the alternative).
83 Hawkland, supra note 78, at 39.
84 Peters, supra note 75, at 279. But see 1 Law Revision Comm'n, supra note 75, at 248 (difficulties with proof of loss test in accord with § 339 of the Restatement of Contracts); Sweet, supra note 5, at 109, (§ 2-718(1) apparently validates reasonable anticipated damages even if not difficult to ascertain at trial).
85 See 1 Law Revision Comm'n, supra note 75, at 248; Peters, supra note 75, at 278-79.
86 See Hawkland, supra note 78, at 39. Dean Hawkland adds that "the difficulty and expense of acquiring or presenting evidence to establish actual damages are matters that justify the use of a liquidated damages provision." Id. But see Peters, supra note 75, at 278-79, where it is suggested that the difficulties of proof of loss and the inconvenience tests must be construed in the alternative to avoid redundancy.
87 Hawkland, supra note 78, at 42.
the Court of Appeals for the Seventh Circuit considered a liquidated damages provision incorporated within a contract to purchase shares of stock. In affirming the denial of motions for summary judgment made by both parties, the court cited section 2-718(1), and held, inter alia, that an issue of fact existed as to whether the stipulated sum was reasonable in comparison with the actual damages. The court, however, seemingly ignored the question whether the provision was reasonable in light of the anticipated damages.

In Unit Vending Corp. v. Tobin Enterprises, a Pennsylvania court, discussing section 2-718(1), stated that "[i]f the amount of damages assessed is subsequently adjudged unreasonable in the light of either anticipated or actual harm, the contractual provision will be voided as a penalty . . . ." This interpretation of section 2-718(1) is manifestly incorrect, however, for section 2-718(1) specifically validates a liquidated damages provision if it is reasonable under either of the harm tests, with no requirement that it be reasonable under both.

Despite occasional misapplication of this section, the courts, consistent with the common law, have held that if a liquidated damages provision is held to be unenforceable, the aggrieved party may recover whatever actual damages he can prove.

**STIPULATIONS TO PAY ATTORNEY'S FEES**

Agreements to pay attorney's fees are most commonly found in promissory notes, mortgages, and leases. Generally, the instrument will provide for a stipulated amount or, if no sum is stated, a
reasonable amount to be recovered by the aggrieved party if the instrument must be placed with an attorney for collection upon default.98

In New York, contractual agreements to pay attorney's fees are generally enforceable.99 In Commercial Investment Trust, Inc. v. Eskew,100 a New York trial court rejected the contention that inclusion of such provisions in promissory notes are unconscionable and against public policy,101 and declared:

Saving the debtor from oppression should not mean relieving him from the force of his own contract and the effects of his own default by absolving him from his contractual liability, and transferring the burden he assumed to the one for whose benefit he engaged to assume it, unless at least the obligation so to be destroyed is on its face unjust and oppressive.102

Although not void as against public policy, there is a divergence of opinion concerning the enforcement of attorney's fees provisions. Some courts have concluded that "the payment of an attorney's fee

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98 See 5 Williston, supra note 1, § 786, at 747.
99 See, e.g., Manufacturers Trust Co. v. Hollinger, 141 N.Y.S.2d 795 (Sup. Ct. N.Y. County 1955) (agreement to pay counsel fees in promissory note upheld); Rosenthal, Contractual Provisions for Attorney's Fees, 40 N.Y.S.B.J. 509, 611 (1968) [hereinafter cited as Rosenthal]. In an overwhelming majority of states, attorney's fees provisions are enforceable. For a partial list of those jurisdictions, see note 115 infra.
100 126 Misc. 114, 212 N.Y.S. 718 (Sup. Ct. Cattaraugus County 1925). In Eskew, the plaintiff initiated suit to recover the unpaid balance on a promissory note, together with 15% of the principal sum as attorney's fees, as provided therein. The agreement specified that this additional amount was to be recoverable should the plaintiff find it necessary to give the instrument to an attorney for collection upon default.
101 As to these allegations, the court stated:
That such provision should be held void as against public policy, in that it encourages litigation, I do not believe. It can more consistently be argued that such provisions would spur the obligors to greater efforts to pay their notes when due, in order to save such fees; thus encouraging the fulfillment of contracts and lessening litigation.

As to such provisions oppressing debtors, they apply to and burden no one who has not contracted therefor.

To vitiate such provision on the ground that it oppresses the debtor is not warranted by fact.


102 126 Misc. at 117, 212 N.Y.S. at 721. Most courts have insisted, as did the Eskew court, that the sum stipulated must be reasonable in amount. See note 105 and accompanying text infra.
is a contractual engagement which the court cannot ignore or revise," regardless of the services actually rendered by the attorney. Most courts, however, have held attorney's fees provisions to be enforceable for the stipulated amount only "if the amount is reasonable and bears a fair relationship to the legal services necessarily incurred by reason of a breach. . . . Where, . . . the amount is arbitrary and excessive, such a provision [has been held to be] in the nature of a penalty and . . . unenforceable." Under the former approach, since no question of fact is involved, attorney's fees may be awarded, as a matter of course, upon a motion for summary judgment. Under the latter approach, however, the court must conduct a factfinding inquiry to ascertain whether the liquidated amount is reasonable. This would normally preclude an award for the stipulated attorney's fees upon a motion for summary judgment. At times, however, even under this latter approach, a hearing is dispensed with if the court is satisfied that the stipu-

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103 In re Mercantile Dye Works, Inc., 177 Misc. 454, 455, 31 N.Y.S.2d 296, 298 (Sup. Ct. N.Y. County 1941). In In re American Motor Prods. Corp., 98 F.2d 774 (2d Cir. 1938), a mortgagee initiated suit to recover, inter alia, 15% of the balance due under the mortgage as attorney's fees. Pursuant to the agreement between the parties, such fees were to be paid by the mortgagor should the mortgagee find it necessary to employ an attorney for collection services upon default. The Second Circuit affirmed the lower court's decision granting the 15% fees, noting that a court is not free to tamper with the agreement of the parties in the absence of fraud or usury.


lated sum is reasonable per se. For example, in *General Lumber Corp. v. Landa,* the plaintiff sued upon a promissory note that contained a provision obligating the defendant to pay twenty percent of the note as attorney’s fees in the event the note was unpaid at maturity and given to an attorney for collection. The trial court held such a stipulation to be void as a penalty, unconscionable, and against public policy. The Appellate Division, Second Department, disagreed, however, and modified the judgment to allow the twenty percent sum, holding that “a sum equal to 20% of the face amount of this note, is a reasonable attorney’s fee for its collection by suit.” Subsequently, some courts have relied upon *General Lumber* as authority for the proposition that a twenty percent attorney’s fees stipulation in a note is prima facie reasonable, regardless of the amount of the principal obligation. Normally, however, in determining the reasonableness of a stipulation for attorney’s fees, a court will consider, inter alia, the attorney’s experience, expertise, and expenditure of time on the matter, including litigation, and the court’s own notions of fairness.

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110 The principal sum of the note, with interest, was $2,281.79. Thus, the attorney’s fees requested amounted to only $393.50, or 20% of the face value of the note.
111 Id. at 805, 216 N.Y.S.2d at 34 (emphasis added).
114 See, e.g., Airways Supermarkets, Inc. v. Santone, 107 N.Y.S.2d 187 (Sup. Ct. Bronx County 1951), aff’d mem., 280 App. Div. 924, 116 N.Y.S.2d 125 (1st Dep’t 1952). Rosenthal, supra note 99, at 514, lists the criteria which the courts have used in judging the reasonableness of a stipulation for attorney’s fees: “(1) the raw percentage, (2) the amount of the fee involved, (3) the base on which the percentage is computed and (4) the value of the services performed.” In *In re Estate of Potts,* 213 App. Div. 59, 209 N.Y.S. 655 (4th Dep’t 1954), the court, in an action involving a claim for attorney’s fees accumulated in conjunction with the management of an estate, articulated the applicable criteria for the court to consider when determining the reasonableness of a claim for counsel fees: “In general, the court... should consider the time spent, the difficulties involved in the matters in which the services were rendered, the nature of the services, the amount involved, the professional standing of the counsel, and the results obtained.” 213 App. Div. at 62, 209 N.Y.S. at 657. For a discussion of the criteria used in setting counsel fees, see Kaufman v. Diversified Indus., Inc., 356 F. Supp. 827 (S.D.N.Y. 1973); Lincoln Rochester Trust Co. v. Freeman, 34 N.Y.2d 1, 311 N.E.2d 480, 355 N.Y.S.2d 336 (1974); Hahn
Attorney's Fees: Contract of Indemnity or Liquidated Damages?

Although in most of the United States, as in New York, agreements to pay attorney's fees are enforceable, in at least two jurisdictions attorney's fees are not recoverable except as expressly provided for by statute. Elsewhere, the courts will generally enforce a stipulation if reasonable in amount. There is, however, a difference of opinion among the jurisdictions on the question of whether an attorney's fees provision is properly considered a contract of indemnity or an agreement to pay liquidated damages. The vast majority of courts consider such a stipulation to be one for indemnity. As was stated by the Court of Appeals for the Tenth Circuit in Webster Drilling Co. v. Walker:

While a provision in a note or other written obligation for the payment of attorney's fees is valid in both Oklahoma and Texas, it is the further rule in both of those states that such a provision is one of indemnity or reimbursement, not one for liquidated damages. And the general rule is that a provision of that kind being one for indemnity . . . as distinguished from one of penalty for nonpayment, the amount fixed in the instrument is prima facie the amount recoverable, but it may be reduced by the court in the exercise of its sound discretion if it is excessive or unreasonable.
Only a few courts have deemed an attorney's fees provision to be an agreement for liquidated damages.\textsuperscript{121} Even some of these courts have hedged on such a construction, holding the stipulation to be only "somewhat in the nature of liquidated damages."\textsuperscript{122} Louisiana alone has consistently declared such stipulations to be liquidated damages provisions.\textsuperscript{123} Even in Louisiana, however, this terminology appears to be merely superficial, for the courts of that state have not construed attorney's fee provisions in light of the rules pertaining to liquidated damages. Instead, the Louisiana courts have enforced these stipulations "in strict accordance with the terms of the particular provision,"\textsuperscript{124} regardless of the services actually performed.\textsuperscript{125} In fact, in one case, the Supreme Court of Louisiana was compelled to remark that whether an attorney's fees stipulation was considered to be a contract of indemnity or a provision for liquidated damages was merely "an academic question, dealing more with the use of words than with the substance of things."\textsuperscript{126}

New York courts impliedly have treated attorney's fees provisions as contracts of indemnity rather than as liquidated damages.\textsuperscript{127} Judicial analysis of these stipulations has been singularly concerned with whether the provision was reasonable in light of the services rendered by the attorney.\textsuperscript{128} Prior to \textit{Equitable Lumber}, no New York court had ever applied the tests for liquidated damages to an agreement to pay attorney's fees.\textsuperscript{129}

\textsuperscript{121} \textit{But see} Farmers' Nat'l Bank v. Rasmussen, 1 Dak. 60, 46 N.W. 574 (1875); Federated Mut. Implement & Hardware Ins. Co. v. Johnson, 53 Tenn. App. 288, 382 S.W.2d 214 (1964).


\textsuperscript{123} \textit{See} Lagarde Fin. Co. v. Vinet, 346 F.2d 846, 850 (5th Cir. 1965) (applying Louisiana law).

\textsuperscript{124} Id. at 850.

\textsuperscript{125} \textit{See} W.K. Henderson Iron Works & Supply Co. v. Meriwether Supply Co., 178 La. 516, 152 So. 69 (1934).


\textsuperscript{127} In Waxman v. Williamson, 256 N.Y. 117, 120, 123, 175 N.E. 534, 535-36 (1931), the court of appeals considered whether a provision for attorney's fees contained in a promissory note was "a debt or liquidated demand," and held that it was the former. \textit{See also} Bank of N.Y. v. Clavier Corp., 29 App. Div. 2d 927, 289 N.Y.S.2d 125 (1st Dep't 1968) (mem.).


\textsuperscript{129} \textit{But see} Liberty Mut. Ins. Co. v. Outerbridge, 42 Misc. 2d 756, 249 N.Y.S.2d 147 (Sup. Ct. Kings County 1963). There, the court held that a provision for attorney's fees in an employment contract was not a penalty, but rather a stipulation for liquidated damages. The court did not, however, construe the provision in light of the tests for liquidated damages.
Analysis of the Equitable Lumber Decision

In Equitable Lumber, the lower court had ruled that the thirty percent attorney's fees stipulation was unreasonable in comparison to the court's estimate of the time and effort necessary for an attorney to handle the plaintiff's claim. Judge Gabrielli, writing for the New York Court of Appeals, determined that this approach was incorrect, stating:

Analysis of the harm suffered by the injured party is the focal point of section 2-718(1). . . . Under both the "actual" and "anticipated" harm tests, the time expended by the attorney in obtaining collection is not necessarily the correct measure of damages, since an attorney would be expected to bill his client on a contingent fee basis.

The court applied the dual harm tests of section 2-718(1), noting that the anticipated harm test would be satisfied if the stipulated amount was "related to the normal contingent fee charged by attorneys in the collection context," and that the actual harm test would be satisfied if the plaintiff had, in fact, agreed upon a thirty percent contingent fee arrangement with its attorney. In a passage of critical importance, the court also indicated that even if a stipulation is reasonable in view of the actual harm suffered, it could still fail under the second sentence of section 2-718(1) if it is "so unreasonably large as to be void as a penalty."

The case was then remanded to the trial court to resolve the following issues:

(1) was a 30% fee reasonable in light of the damages to be anticipated by one in the plaintiff's position, that is, was the fee reasonably related to the normal fee an attorney would charge for the collection of plaintiff's claim; or, alternatively, (2) was the fee commensurate with the actual arrangement agreed upon by the plaintiff and its attorney? Even if the 30% fee did correspond to the actual arrangement between plaintiff and its attorney, the court on remand should determine whether the amount stipulated was unreasonably large or grossly disproportionate to the damages.

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120 38 N.Y.2d at 523, 344 N.E.2d at 397, 381 N.Y.S.2d at 464.
121 Id. at 524, 344 N.E.2d at 397, 381 N.Y.S.2d at 464-65.
122 Id., 344 N.E.2d at 397, 381 N.Y.S.2d at 465.
123 Id.
124 Id. Judge Gabrielli noted: "If plaintiff entered into an exorbitant fee arrangement with counsel, knowing that defendant would suffer the consequences, then the liquidated damages provision would be void as a 'term fixing unreasonably large liquidated damages.'" Id. See N.Y.U.C.C. § 2-718(1) (McKinney 1964).
which the plaintiff was likely to suffer from breach in the event it did not rely on respondent's agreement to pay its attorney's fees. If the amount is found to be unreasonably large, then the provision is void as a penalty.\textsuperscript{135}

In so construing section 2-718(1), one of the court's avowed purposes was to waylay the threat of collusion between the plaintiff and his attorney. As Judge Gabrielli stated, "[w]hile plaintiff may enter into any fee arrangement it wishes with counsel, it should not be permitted to manipulate the actual damage incurred by burdening the defendant with an exorbitant fee arrangement."\textsuperscript{136} Unfortunately, the solution to this problem offered by the court appears to raise more questions than it resolves.

Equitable Lumber: The "Anticipated Harm" Test

Under the anticipated harm test, the court directed the judicial inquiry to focus upon ascertaining the "normal fee" charged by an attorney for handling the plaintiff's claim.\textsuperscript{137} The court indicated that "since an attorney would be expected to bill his client on a contingent fee basis,"\textsuperscript{138} the anticipated harm can be established by determining the average contingent fee charged for a collection matter. It is suggested that it would be unfortunate if the inquiry into the anticipated harm is limited to a search for a "typical" contingent fee. While this method arguably might assess a plaintiff's anticipated harm if he has actually negotiated for his attorney's services on a contingent fee basis, or if he has not established method of payment for his attorney's services, \textit{quaere}, whether this method is applicable if the parties have entered into a different fee arrangement? For example, if a plaintiff has agreed to compensate his attorney on an hourly basis, the average contingent fee percentage charged for handling this matter would be irrelevant in establishing the plaintiff's anticipated harm. Similarly, if the attorney is on retainer, the typical contingent fee charged for a collection would not be germane to establishing the plaintiff's anticipated harm for this particular transaction.

On the other hand, what if the court should determine that a collection matter typically is not handled on a contingent fee

\textsuperscript{135} 38 N.Y.2d at 524, 344 N.E.2d at 397, 381 N.Y.S.2d at 465.
\textsuperscript{136} Id.
\textsuperscript{137} Id.
\textsuperscript{138} Id.
basis? For example, suppose the plaintiff, about to enter into a contract with the defendant, hired a prestigious law firm to represent him in the negotiations. The plaintiff's firm, as a matter of course, charges higher fees than the average law firm. The plaintiff and his attorney, without collusion, agreed that the firm would charge the plaintiff $1500 if collection was necessary. The plaintiff communicated this fee arrangement to the defendant, and the parties agreed to include this sum in their contract as the amount the defendant would pay should he subsequently breach the contract, and thus force the plaintiff to hand the matter over to his attorney for collection. If upon breach, and after the attorney had rendered his services, the court determined that the normal fee to be anticipated for this type of matter is $500, the contract stipulation might fail the anticipated harm test under *Equitable Lumber* despite the fact that it was entered into without collusion between the plaintiff and his attorney, and despite the fact that this was, in actuality, the harm anticipated by the parties when they entered into the contract.

In effect, the court's interpretation of the anticipated harm test shifts the focus of judicial inquiry from the contract negotiated by the parties, with all its attendant circumstances and exigencies, to an objective standard of reasonableness wholly foreign to their agreement. While this may succeed in preventing collusive fee arrangements, it will also invalidate many noncollusive agreements which, although reasonable in themselves, are deemed unreasonable in comparison to this external standard.

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139 Such a finding is unlikely, however, for collection work is generally handled on a contingent fee basis. See Schiff, *Should a Commercial Attorney Accept Retail Collections—A Critical Analysis*, 78 Com. L.J. 50 (1973).

140 See text accompanying note 137 supra. It should be noted that under *Equitable Lumber*, when confronted with such a situation, the court would go on to assess the validity of the stipulation under the actual harm test.

141 In its directions to the lower court on remand, the court of appeals instructed that court to determine whether a 30% fee was "reasonable in light of the damages to be anticipated by one in the plaintiff's position . . . ." 38 N.Y.2d at 524, 344 N.E.2d at 397, 381 N.Y.S.2d at 465. If this were the extent of the instruction, then the hypothetical situation discussed in the text above would pose no problem under the court's interpretation of the anticipated harm test. The remainder of the sentence, however, appears to limit this instruction by restricting the judicial inquiry to an examination of whether the 30% fee was "reasonably related to the normal fee an attorney would charge for the collection of plaintiff's claim . . . ." Id. Such a limitation would present only a single criterion for the court to consider when assessing the reasonableness of a liquidated damages provision. As such, the validity of a stipulation would hinge on its relationship to a factor extraneous to the contract.

142 The court's application of an independent standard as the single determinant of reasonableness under its interpretation of § 2-718(1) might be in conflict with the official
Equitable Lumber: The "Actual Harm" Test

The court's interpretation of the actual harm test\(^{143}\) presents similar difficulties. It is clear from the opinion that if the plaintiff and his attorney had actually agreed to a thirty percent contingent fee, then the plaintiff's actual harm would be in accord with the liquidated damages stipulation.\(^{144}\) Yet, the court indicates that such a provision might still fail pursuant to the second sentence of section 2-718(1) if it was "so unreasonably large as to be void as a penalty."\(^{115}\) This construction is a radical departure from prior interpretation of the actual harm test, which would focus only upon ascertaining the actual damages suffered.\(^{146}\) If the liquidated damages stipulation was reasonably related to this actual damage, even if wholly by accident, the inquiry would end, and the provision would be enforced.\(^{147}\) Under the actual harm test as interpreted in Equitable Lumber, however, even if the plaintiff, without collusion, actually suffered damages equal to the stipulated amount, the court could refuse to enforce the provision if it found the stipulation disproportionate to some objective yardstick of reasonableness foreign to the contract.\(^{148}\) Thus, the court has again tied the viability of a

commentary under that section, which states in pertinent part: "Under subsection (1) liquidated damage clauses are allowed where the amount involved is reasonable in the light of the circumstances of the case." Uniform Commercial Code § 2-718(1), Comment 1 (emphasis added).

\(^{113}\) See text accompanying notes 134-35 supra.

\(^{114}\) 38 N.Y.2d at 524, 344 N.E.2d at 397, 381 N.Y.S.2d at 465.

\(^{115}\) Id.


\(^{118}\) The court of appeals failed to indicate, however, whether a stipulation which is unreasonably small in relation to the normal contingent fee charged for collections would likewise be considered unenforceable under the court's interpretation of § 2-718(1). The official commentary to this section states in pertinent part: "A term fixing unreasonably large liquidated damages is expressly made void as a penalty. An unreasonably small amount would be subject to similar criticism and might be stricken under the section on unconscionable contracts or clauses." Uniform Commercial Code § 2-718, Comment 1 (emphasis added). One commentator suggests that an unreasonably small sum would be considered void as a penalty. See 3A DuSenberg & King, supra note 74, § 14.08, at 14-64. See generally Fritz, "Underliquidated" Damages as Limitation of Liability, 33 Tex. L. Rev. 196 (1954); Ganz, Limitation of Liability Under the Sales Provisions of the Uniform Commercial Code, 14 De Paul L. Rev. 73, 80 (1964), which adopt the position that unreasonably small sums would be unenforceable as unconscionable.

Judge Gabrielli indicated that the section of the UCC dealing with unconscionability, § 2-302, is inapplicable to the case at bar since here the parties were "commercial entities dealing at arm's length with relative equality of bargaining power. . . . Defendant IPA, therefore, cannot assume the posture of a commercially illiterate consumer beguiled into a
liquidated damages provision to a contingency wholly outside the agreement negotiated by the parties.\textsuperscript{149}

** DAMAGES RECOVERABLE IF THE PROVISION IS UNENFORCEABLE **

In its discussion of liquidated damages, the court failed to answer an important question, namely, what damages may the plaintiff recover should the court hold the stipulation to be unenforceable under both harm tests. It is settled law that if a liquidated damages provision is held to be unenforceable, the plaintiff may recover any actual damages which he can prove.\textsuperscript{150} Applying this rule in *Equitable Lumber*, however, might yield absurd results. For example, even if a stipulation failed the actual harm test as being disproportionate to the "normal fee" charged in that context, would the plaintiff still be able to recover the stipulated amount, since it would be equal to his actual damages?

** MAY AN ATTORNEY'S FEES PROVISION PROPERLY BE CONSIDERED A STIPULATION FOR LIQUIDATED DAMAGES? **

Undoubtedly, the most significant statement made by the court was its summary characterization of the clause at issue in *Equitable Lumber* as an agreement for liquidated damages.\textsuperscript{151} The rationale offered for this construction was that "[a]t the time of contracting the attorney's fees were arguably incapable of estimation."\textsuperscript{152} As previously discussed, however, the estimation test has been rejected by the New York courts in favor of the difficulty of ascertainment test.\textsuperscript{153} Under this latter standard, the court's characterization of an grossly unfair bargain by a deceptive vendor or finance company." 38 N.Y.2d at 523, 344 N.E.2d at 396, 381 N.Y.S.2d at 464. For an example of a situation involving unconscionability, see Jones v. Star Credit Corp., 59 Misc. 2d 189, 298 N.Y.S.2d 264 (Sup. Ct. Nassau County 1969).

Judge Gabrielli did not deny the relevancy of § 2-302 in appropriate circumstances, however, since "[i]n the proper case a provision that one party to a contract pay the other party's attorney's fees in the event of breach may be unconscionable." 38 N.Y.2d at 523, 344 N.E.2d at 396, 381 N.Y.S.2d at 464. See N.Y.U.C.C. § 2-302 (McKinney 1964). For discussion of this section and the subject of unconscionability under the Code, see Asch, "Unconscionable" Sales Contracts in New York, 17 Advocate 65 (1970); Leff, Unconscionability and the Code—The Emperor's New Clause, 115 U. Pa. L. Rev. 485 (1967); Note, Unconscionable Contracts: The Uniform Commercial Code, 45 Iowa L. Rev. 843 (1960); Note, Unconscionable Contracts Under the Uniform Commercial Code, 109 U. Pa. L. Rev. 401 (1960).

\textsuperscript{149} See notes 141-42 and accompanying text supra.

\textsuperscript{150} See note 96 and accompanying text supra.

\textsuperscript{151} 38 N.Y.2d at 523, 344 N.E.2d at 396, 381 N.Y.S.2d at 464.

\textsuperscript{152} Id., 344 N.E.2d at 396-97, 381 N.Y.S.2d at 464 (emphasis added).

\textsuperscript{153} See note 57 and accompanying text supra. The New York Annotations to § 2-718 state,
attorney's fees stipulation as a liquidated damages provision may seriously be questioned, since attorney's fees do not appear to be difficult to ascertain.\(^{164}\)

To be a valid liquidated damages clause under both the common law and the Code, the damages which result upon breach must be difficult to establish.\(^{165}\) If the actual harm is relatively easy to determine, there is no necessity for the parties to agree in advance on damages.\(^{156}\) While attorney's fees may be a matter of conjecture at the time the parties enter into the contract, they clearly are ascertainable at trial once the attorney's services have been rendered. As such, an attempt to liquidate attorney's fees could be considered void ab initio.\(^{157}\) Nevertheless, in *Equitable Lumber*, the New York Court of Appeals characterized an attorney's fees provision as a stipulation for liquidated damages.\(^{158}\) The import of the decision lies in the consequences of this characterization.

\(^{154}\) At times, courts have been confronted with a stipulation for liquidated damages and an attorney's fee provision contained within the same contract. In such situations, the courts have construed these clauses under different analyses. Thus, in *Fairfield Lease Corp. v. Marsi Dress Corp.*, 60 Misc. 2d 363, 303 N.Y.S.2d 179 (N.Y.C. Civ. Ct. N.Y. County 1969), the plaintiff's assignor and the defendants entered into an agreement in which the defendants covenanted to rent a machine from the plaintiff's assignor on a monthly basis. The contract provided, *inter alia*, that upon any default, the lessor could accelerate all future rents due thereunder, and recover an additional 20% as attorney's fees if counsel had to be retained to handle the matter. The court first examined the acceleration clause in light of the tests for liquidated damages, concluding that the provision was an unenforceable penalty. When
CONCLUSION

Agreements to pay attorney's fees are included, almost as a matter of course, in most promissory notes, mortgages, leases, and other contracts. In construing such stipulations in the past, New York courts have generally sought to determine whether the provision was reasonable in light of the legal services rendered.

Under *Equitable Lumber*, this analysis has been rendered suspect. In an attempt to prevent collusive fee arrangements, the

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considering the agreement to pay attorney's fees, however, the court utilized a different approach, stating:

A contract may provide for the payment of attorney's fees by a defaulting party, but those fees are recoverable solely as a contract right and not as damages.

However, the stipulated fee must bear a reasonable relationship to the legal services necessarily incurred by reason of the breach of contract. A provision for the payment of an arbitrary amount as an attorney's fee would be in the nature of a penalty and therefore unenforceable.

*Id.* at 366, 303 N.Y.S.2d at 182 (citations omitted).

Similarly, in Carol Management Co. v. Baring Indus., 257 So. 2d 270 (Fla. App. 1972) (per curiam), the buyer sued the seller for breach of a sales contract. The contract provided, *inter alia*, that if the buyer canceled the agreement, any monies already paid as a downpayment would be forfeited to the seller as liquidated damages. Another provision stated that the buyer would pay the seller's reasonable attorney's fees if the contract had to be turned over to an attorney for enforcement. Like the court in *Fairfield Lease*, the Carol Management court applied the liquidated damages tests in construing the first provision, while applying a different test in its analysis of the attorney's fee stipulation.

Similarly, the contract involved in *Equitable Lumber* specifically included a liquidated damages provision in addition to the stipulation for attorney's fees. This clause stated:

If the Buyer should breach this contract, or where Seller has a right to terminate this contract, in addition to any other rights, remedies or causes of action provided by law or by this contract, the Seller shall be entitled to the profits it would have earned had the Buyer performed. The Buyer and Seller agree that in such event the Buyer shall pay to the Seller as liquidated damages ten (10%) per cent of the contract price on the material remaining undelivered and the parties agree that same represents a fair figure for such unliquidated damages, and that the exact damages and profits the Seller would earn are impossible and difficult to determine.

Brief for Appellant at A-20 (emphasis added).

159 *See* note 97 and accompanying text *supra*.

160 *See* notes 105, 113 & 114 and accompanying text *supra*. In a deposition given by the plaintiff's attorney in *Equitable Lumber*, counsel noted the services he had rendered in his client's behalf, including: (1) an investigation was conducted into his client's rights under the Lien Law; (2) counsel visited the site where defendant was going to use the materials purchased in order to prepare a plot plan; (3) a title search was made of the property; (4) a mechanic's lien was prepared; (5) the complaint served upon the defendant was prepared; (6) legal research into the issues raised in litigation was conducted; and (7) the judgment would have to be collected, which might include future litigation. Brief for Appellant at A-27 to -28.

161 *See* notes 130 & 131 and accompanying text *supra*.

162 While the court of appeals was attempting to prevent collusion between the plaintiff and its attorney, it is interesting to note that the plaintiff in *Equitable Lumber* had agreed to pay its attorney a fee *in excess of 30%*. Brief for Appellant at A-28.
court of appeals has tied the enforcement of a stipulation for attorney's fees to a standard independent of the contract. Although the decision, strictly speaking, is applicable only to contracts for the sale of goods, its rationale appears to extend beyond this context. Since the court unequivocally and without reservation characterized the clause in issue as a liquidated damages provision, it is only logical to assume that the rationale of *Equitable Lumber* extends to similar clauses found in leases, mortgages, promissory notes, and other legal instruments.

Although the court, in the instant case, scrutinized only attorney's fees, the analysis of section 2-718(1) offered would appear applicable to any other kind of damages which the parties might desire to liquidate. As such, parties run the risk that the validity of their stipulation may be tied to an external standard—one not contemplated by the parties when they negotiated the provision.

In addition, *Equitable Lumber* appears contrary to the *raison d'être* of liquidated damages, namely, judicial economy. The essence of the law of liquidated damages is the judicial recognition that

> the award of a court or jury is no more likely to be exact compensation than is the advance estimate of the parties themselves . . . .

> [T]he enforcement of such estimates saves the time of courts, juries, parties, and witnesses, and reduces the expense of litigation.\(^{104}\)

In going beyond the agreement of the parties, *Equitable Lumber* has broadened the court's role in assessing a liquidated damages stipulation, while diminishing the economy and value of such a provision. In the wake of this decision, it is highly unlikely that a court could enforce an attorney's fees provision, or any kind of liquidated damages stipulation, without first conducting a fact-finding inquiry, thus precluding adjudication upon a motion for summary judgment.\(^{105}\)

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\(^{103}\) At least one court has extended the applicability of *Equitable Lumber* beyond the scope of article 2. See *Truck Rent-A-Center, Inc. v. Puritan Farms, 2nd Inc.*, 51 App. Div. 2d 786, 789 n.2, 380 N.Y.S.2d 37, 42 n.2 (2d Dep't 1976) (mem.), where Justice Shapiro, writing for the dissent, cited *Equitable Lumber* as a general authority on the law of liquidated damages in a case involving an action for breach of a lease.

\(^{104}\) 5 *CORBIN*, *supra* note 2, § 1060, at 348 (footnote omitted). Dean Hawkland adds that "the hazard of being exposed to the vagaries of a jury passing on the amount of damages" is a primary reason for utilizing a liquidated damages provision. Hawkland, *supra* note 78, at 39. See generally *Sweet*, *supra* note 5, at 86-87.

\(^{105}\) Under *Equitable Lumber*, it is difficult to envision how attorney's fees may ever be awarded upon a motion for summary judgment, since the court must now inquire beyond the actual contract to determine the reasonableness of a stipulation. Clearly, an investigation of
The court of appeals must elucidate its decision before the full implications of *Equitable Lumber* are understood. It must clearly define the limits of the decision, and the extent of its applicability in a nonsales context. Until then, the import of *Equitable Lumber* is at best a matter of conjecture.

*Robert M. Miller*

this nature will require a hearing to be conducted in every case. This undermines the reason for the parties to negotiate such a provision, which is to obviate the necessity of litigating the issue. Telephone interview with Max Ornstein, Attorney for the Appellant, Feb. 3, 1976.