The Reasonableness of Liquidated Damages Provisions—Why Only the Look Back Approach Can Prevent Windfalls

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Pope Benedict XVI never divined a leading role in a cutting edge liquidated damages case, but that is precisely what happened recently in the nation's capital. The owners of the Washington Nationals, the Major League Baseball franchise in the District of Columbia, recently demanded at least $100,000 a day in liquidated damages because, they argued, the new stadium built by the District for the Nationals was not "substantially complete" by the construction contract's deadline of March 1. Countering that notion, the District's local government, which owns the taxpayer-financed stadium, rolled out the Pope to support their argument that beneficial occupancy of the stadium occurred as scheduled. After all, Pope Benedict delivered mass in April "before more than 45,000 people without a glitch."[1]

Indeed, by the time the team's owners demanded liquidated damages, the ballpark had played host to 48 regular season baseball games, a sellout exhibition game against the Baltimore Orioles, and even a college baseball game.[2] The owners argued, nonetheless, that even though "all the revenue-generating portions of the ballpark were completed well before Opening Day," several punch list items remained incomplete, including the team's new office suite in the stadium.[3]

Contract clauses liquidating damages for delay are a commonly accepted feature of construction contracting. The attractiveness

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[1]LeDuc and Nakamura, Nationals Withhold Rent on Ballpark, Wash. Post, July 11, 2008, at B1.

[2]LeDuc and Nakamura, Nationals Withhold Rent on Ballpark, Wash. Post, July 11, 2008, at B1.

[3]LeDuc and Nakamura, Nationals Withhold Rent on Ballpark, Wash. Post, July 11, 2008, at B1.

of liquidated damages provisions stems from the desire to avoid litigation by stipulating the scope and extent of damages in advance of a contract breach.[4] Unfortunately, the prevailing confusion in the law of liquidated damages compromises the clauses' primary justification. Under well-established decisional law, a liquidated damages provision is unenforceable if it is classified as a "penalty."[5] The key factor in determining whether such a provision is an unenforceable penalty or an enforceable stipulation of damages is whether the liquidated damages clause is a reasonable pre-estimate of the damages.[6] The "reasonableness" analysis, however, turns almost entirely on the point in time at which reasonableness is conjured.

The dispute between the Nationals and the District of Columbia was resolved privately before the matter was fully litigated, and without papal intercession,[7] but the difficult legal issues at the heart of the dispute remain unsettled. Indeed, this dispute resonates as an escalating discommode in the industry. In hindsight, $100,000 a day in liquidated damages for a stadium project where all the revenue-generating events went off without a hitch seems excessive, or in other words, like a penalty. Yet at the time the city and the team negotiated the liquidated damages clause, the amount may very well have been a reasonable pre-estimate of damages. In fact, had the team been forced to hold its

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[4]See Carrothers Const. Co., L.L.C. v. City of South Hutchinson, 288 Kan. 743, 207 P.3d 231, 241 (2009) ("[Liquidated damages] provisions allow contracting parties to protect themselves against the difficulty, uncertainty, and expenses that necessarily follow judicial proceedings when trying to ascertain actual damages."); District Cablevision Ltd. Partnership v. Bassin, 828 A.2d 714, 723 n.12, 51 U.C.C. Rep. Serv. 2d 149 (D.C. 2003); Wassenaar v. Panos, 111 Wis. 2d 518, 331 N.W.2d 357, 362, 40 A.L.R.4th 266 (1983).

[5]Carrothers Constr. Co., 207 P.3d at 241; Repair Masters Constr., Inc. v. Gary, 277 S.W.2d 854, 857 (Mo. App. 2009); McQueen, Rains & Tresch, LLP v. Citgo Petroleum Corp., 2008 OK 66, 195 P.3d 35, 46 (Okla. 2008); Kozlik v. Emelco, Inc., 240 Neb. 525, 483 N.W.2d 114, 121, 127 Lab. Cas. (CCH) P 57599 (1992); see, generally, 2 Joseph M. Perillo, Corbin on Contracts § 58.5 (Rev. ed. 2005) [hereinafter Corbin on Contracts].

[6]McQueen, Rains & Tresch, 195 P.3d at 46; Orr v. Goodwin, 157 N.H. 511, 953 A.2d 1190, 1194 (2008); Raisin Memorial Trust v. Casey, 2008 ME 63, 945 A.2d 1211, 1215 (Me. 2008); see, generally, Corbin on Contracts § 58.5.

[7]Aaron C. Davis, Team to Pay City $3.5 Million in Rent Settlement, Wash. Post, Oct. 19, 2008, at C4. Under the terms of the settlement, the Nationals agreed to pay the city $3.5 million in rent payments that had been withheld as part of the liquidated damages dispute, and the city agreed to pay for almost $4 million in withheld stadium improvements before the end of 2008. Aaron C. Davis, Team to Pay City $3.5 Million in Rent Settlement, Wash. Post, Oct. 19, 2008, at C4.

first several games in a smaller or much older venue, it likely would have experienced significant delay damages. That did not happen, however, making these damages appear in hindsight to fall far closer to the penalty end of the spectrum.

Courts are split as to the temporal point from which reasonableness should be judged.[8] Those courts that employ what is known as the "single look" approach assess reasonableness exclusively from the moment of contract formation and bar the fact-finder from considering the actual damages that flowed from the breach of contract.[9] Under this approach, the fact that no actual damages were incurred is legally inconsequential. A contrary legal model is employed by a fewer number of courts that employ what is called the "second look" approach, which permits a retrospective analysis. This model considers reasonableness in the context of the quantum of actual damages suffered, barring recovery if there is a great discrepancy between the liquidated sum and the actual damages.[10]

This article is an apologia for the adoption of a modified version of what is currently the minority model. The better view of the problem posits that courts and arbitrators reject the single look model. Blindly adhering to the "single look" model too often generates windfall recoveries that bear no resemblance to damages suffered, preserves no real contractual expectations, and instead undermines the shared expectations of the contracting parties. The single look model awards one party what in reality is a penalty. The underlying rationale cited in support of the majority view is the strong, countervailing interest in enforcing the

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[8]Compare Barrie School v. Patch, 401 Md. 497, 933 A.2d 382, 390, 225 Ed. Law Rep. 973 (2007) (adopting what is known as the "single look" approach); Guiliano v. Cleo, Inc., 995 S.W.2d 88, 100, 16 I.E.R. Cas. (BNA) 1015, 139 Lab. Cas. (CCH) P 58713 (Tenn. 1999) (same); Dist. Cablevision, 828 A.2d at 724 (same); Kelly v. Marx, 428 Mass. 877, 705 N.E.2d 1114, 1117 (1999) (same); Watson v. Ingram, 124 Wash. 2d 845, 881 P.2d 247, 250 (1994), with Orr, 953 A.2d at 1194 (adopting what is known as the "second look" approach); Wheeling Clinic v. Van Pelt, 192 W. Va. 620, 453 S.E.2d 603, 609 (1994) (same); Kozlik, 483 N.W.2d at 121 (same); Shallow Brook Associates v. Dube, 135 N.H. 40, 599 A.2d 132, 137 (1991) (same).

[9]Barrie School, 933 A.2d at 390; Carrothers Constr., 184 P.3d at 950; Renaudette v. Barrett Trucking Co., Inc., 167 Vt. 634, 712 A.2d 387, 388 (1998); see, generally, Corbin on Contracts § 58.6.

[10]Orr, 953 A.2d at 1193; Kozlik, 483 N.W.2d at 121; Westhaven Associates, Ltd. v. C.C. of Madison, Inc., 257 Wis. 2d 789, 2002 WI App 230, 652 N.W.2d 819, 826 (Ct. App. 2002); see, generally, Corbin on Contracts § 58.6.

parties' freedom to contract.[11] The absolute nature of the single look approach, however, disregards the equally important legal maxim that penalties will not be enforced in contract.[12] Indeed, the "freedom of contract" interests supposedly served by the single look model are often not apparent in the actual application of the single look model's theoretical construct.

This article proceeds by introducing a hypothetical in Part I that serves to set the context and highlight the problems presented by the single look approach to liquidated damages. Part II offers a summary of the current law governing liquidated damages provisions. Part III offers our defense for abandoning the single look model in favor of a "look back" to actual damages. Awarding the damages actually incurred advances the real expectation of the contracting parties and promotes a more realistic solution to resolving construction disputes arising out of real delays.

I. Introduction to the Problem—The Concert Hall Hypothetical

Imagine a construction contract for a large concert hall. The builders have agreed with the owners to include in the contract a provision providing for liquidated damages of $20,000 per day for each day of delay that passes without substantial completion of the project. Rather than rely on the default definition of "substantial completion" that would be supplied by contract law,[13] the parties have agreed in the contract that certain items must be completed for substantial completion to occur. For example, the contract requires "delivery of all operating manuals for

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[11]See, e.g., Arrowhead School Dist. No. 75, Park County v. Klyap, 2003 MT 294, 318 Mont. 103, 79 P.3d 250, 256, 182 Ed. Law Rep. 915, 20 I.E.R. Cas. (BNA) 872 (2003) ("The fundamental tenet of modern contract law is freedom of contract . . .."); Dist. Cablevision, 828 A.2d at 724; Kelly, 705 N.E.2d at 1117.

[12]See, e.g., Shallow Brook Associates v. Dube, 135 N.H. 40, 599 A.2d 132, 137 (1991); Wasserman's Inc. v. Township of Middletown, 137 N.J. 238, 645 A.2d 100, 107 (1994).

[13]Substantial completion under the default terms supplied by contract law would occur "when the structure or a portion thereof can be used for the purpose for which it is intended." Schwartzkopf & J. McNamara, Calculating Construction Damages § 13.05 (2d ed. 2001); see Ocean Winds Corp. of Johns Island v. Lane, 347 S.C. 416, 556 S.E.2d 377, 379 (2001) (defining "substantial completion" by reference to S.C. Code Ann. § 15-3-630); Meyer v. Bryson, 891 S.W.2d 223, 225, Prod. Liab. Rep. (CCH) P 14029 (Tenn. Ct. App. 1994) (noting that the most popular definition of substantial completion, as shown by its use in documents from the American Institute of Architects, is that "construction is substantially complete when the owner can occupy [the structure] or use it for the purpose for which it was intended").

mechanical systems," and "notification of all claims, demands, or requests for extra payment" before the project can be considered substantially complete. In addition, a number of specific items must be installed before substantial completion occurs. Substantial completion also turns on the final installation of items like the heating and cooling systems, electrical systems, and even decorative marble columns to set the stage for the concert hall's "Romanesque" entrance.

When a certificate of occupancy was issued by the architect for the owners to take beneficial occupancy of the concert hall, a number of items included in the contract's definition of substantial completion remained unfinished. The operating manual for the loading dock's garage door was not delivered to the owners by the substantial completion deadline specified in the contract. The heating and cooling system was not operational in one of the hall's bathrooms. Some exposed wiring, which did not present a safety issue, was visible in the downstairs hallway. The mezzanine level was not completed by the date on which the first performance was scheduled to occur. Thus, assuming that the mezzanine level represents 10% of the hall's seating, the concert hall's owners would only be able to realize ninety percent of the hall's potential revenue production. Finally, the contract called for genuine marble columns to be installed in the hall's grand entryway, but the builder instead installed "faux marble" columns.

These various problems can be classified into different categories of damages. True delay damages, which turn on the inability to use the facility for its beneficial purpose and which grow in magnitude over time, fall into the first category.[14] For example, the failure to complete the mezzanine level in time for scheduled performances represents true delay damages. The hall's owner is prevented for using 10% of the hall for its beneficial purpose, *i.e.*, to produce revenue, and that harm to the owner grows for each additional performance. In the construction context in general,

[14]See, e.g., Perini Corp. v. Greate Bay Hotel & Casino, Inc., 129 N.J. 479, 610 A.2d 364 (1992) (abrogated on other grounds by, Tretina Printing, Inc. v. Fitzpatrick & Associates, Inc., 135 N.J. 349, 640 A.2d 788 (1994)) (upholding award of lost profit damages due to delayed renovations of casino); see, generally, Bruner & O'Connor on Construction Law § 19:65 [hereinafter Bruner & O'Connor] ("Loss of project use, which can result in lost operating or rental profits, due to inexcusable contractor delay, is a basic element of owner damages, unless waived.").

the law of liquidated damages is designed to deal with the problem of true delay damages.[15]

The second type of damages implicated by the hypothetical are those "time-related" damages that would not ordinarily be classified as delay damages. The builder's failure to deliver the necessary operating manuals and the exposed wiring, for example, are only related to time because the completion of these punchlist items is incorporated into the contract's definition of substantial completion. While the contract specifies that substantial completion is not achieved until these items are complete, these damages are distinct from true delay damages. They do not prevent the owner from using the property for its beneficial purpose[16] and the magnitude of the harm does not grow with each passing day. The third and final category of damages, which do not relate to time or delay at all, can be called "diminution in value" damages.[17] The installation of the "faux marble" in place of the real marble is an example of this category of damages. Because they are not related to delay, these are not the type of damages with which liquidated damages doctrine is concerned.

Returning to the defects presented in the concert hall hypothetical, assume that the full slate of revenue-producing events was held at the hall as originally planned. Nevertheless, the owners claim the right to collect the full liquidated damages amount of $20,000 per day. A full year has passed since the date by which substantial completion was to occur, so the property owners are seeking a liquidated damages award totaling $7.3 million. The property owners argue that the contract calls for liquidated damages for delay past the date of substantial completion, and that substantial completion is carefully defined in the contract to which the builders consented.

The builders, on the other hand, claim that awarding liquidated damages in this situation would simply provide a windfall to the owners. All of the scheduled events were held at the hall, and therefore there was no major loss of revenue to the owners. The owner is attempting to receive 100% of the liquidated damages amount even though only 10% of the hall's seating was un-

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[15]See Hoffar and Ewald, Liquidated Damages and the Freedom to Contract, 1 Journal of the American College of Construction Lawyers 1, 185, 186–187; see, e.g., Carr-Gottstein Properties, Ltd. Partnership v. Benedict, 72 P.3d 308, 311 (Alaska 2003); City of Elmira v. Larry Walter, Inc., 76 N.Y.2d 912, 563 N.Y.S.2d 45, 564 N.E.2d 655, 656 (1990).

[16]See, e.g., Perini Corp., 610 A.2d at 376.

[17]See, e.g., Tydings v. Loewenstein, 505 A.2d 443, 447 (Del. 1986).

available due to the builder's delay. The remaining damages were not true delay damages. The faux marble columns and the late delivery of the manuals might have resulted in the owners receiving less than they bargained for, and thus some actual damage flowing to the owners, but they do not justify liquidated damages for delay that could reach millions of dollars. It is not as if, by contrast, events had to be cancelled or even moved to a different, perhaps smaller, venue.

This hypothetical dispute between the owners and the builders isolates the differences between the single look and second look approaches to assessing the reasonableness of liquidated damages provisions. This article is concerned specifically with how the two approaches confront the argument that allowing liquidated damages in this situation generates a windfall to the owners and which legal model presents the contracting parties with a rational solution to that problem.

II. Summary of the Law Governing Liquidated Damages Provisions

Historically, liquidated damages clauses were viewed by courts with skepticism, but modern courts have embraced their use.[18] Today, liquidated damages will be presumed to be reasonable, and thus enforceable, and the burden is on the party seeking to set aside a liquidated provision to prove that it is a penalty.[19]

Whether the parties' agreement contains an unenforceable penalty or an enforceable liquidated damages provision is determined by reference to three factors: (1) the intention of the parties, (2) whether the damages are uncertain in amount or difficult to prove, and (3) whether the damages clause is a reason-

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[18]See JMD Holding Corp. v. Congress Financial Corp., 4 N.Y.3d 373, 795 N.Y.S.2d 502, 828 N.E.2d 604, 609 (2005); XCO Intern. Inc. v. Pacific Scientific Co., 369 F.3d 998, 1002 (7th Cir. 2004) (Posner, J.) ("The rule (against penalty clauses) hangs on, but is chastened by an emerging presumption against interpreting liquidated damages clauses as penalty clauses."); see, generally, Williston on Contracts § 65:1 (4th ed.); see Charles T. McCormick, Damages § 147, at 603 (1935) ("[T]o-day the pendulum is swinging in the other direction, and the tendency is rather towards resolving the doubt in favor of the enforceability of such clauses as agreements for liquidated damages.").

[19]See TAL Financial Corp. v. CSC Consulting, Inc., 446 Mass. 422, 844 N.E.2d 1085, 1092 (2006); Rodriguez v. Learjet, Inc, 24 Kan. App. 2d 461, 946 P.2d 1010, 1013, 36 U.C.C. Rep. Serv. 2d 122 (1997); Shallow Brook Associates v. Dube, 135 N.H. 40, 599 A.2d 132, 137 (1991); MetLife Capital Financial Corp. v. Washington Ave. Associates L.P., 159 N.J. 484, 732 A.2d 493, 499 (1999); P. J. Carlin Const. Co. v. City of New York, 59 A.D.2d 847, 848, 399 N.Y.S.2d 13 (1st Dep't 1977); Wassenaar v. Panos, 111 Wis. 2d 518, 331 N.W.2d 357, 361, 40 A.L.R.4th 266 (1983).

able pre-estimate of the damages.[20] The "intent of the parties" is currently the least important factor.[21] Neither the Restatement Second nor the Uniform Commercial Code provides for considering the parties' intent,[22] and even those jurisdictions that claim to consider the issue instead focus more closely on the reasonableness of the damages estimate.[23] The "difficulty in ascertaining damages" has also become less relevant, especially in the case of delay damages, which are "nearly always difficult to determine."[24]

The heart of a litigated damages dispute focuses on whether the liquidated sum in the contract constitutes a reasonable estimate of the parties' foreseeable damages.[25] Courts are split, however, as to the time period from which the reasonableness of liquidated damages should be assessed. The split has generated two competing legal models. The first, called the "single look" model, presents a prospective test: the liquidated damages must be reasonable only at the time of contract formation.[26] The alternative model, known as the "second look" approach, presents

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[20]Williston on Contracts § 65:3; 2 Joseph M. Perillo, Corbin on Contracts § 58.5 (Rev. ed. 2005) [hereinafter Corbin on Contracts].

[21]Wallace Real Estate Inv., Inc. v. Groves, 72 Wash. App. 759, 868 P.2d 149, 155 (Div. 1 1994), decision aff'd, 124 Wash. 2d 881, 881 P.2d 1010 (1994); Lake Ridge Academy v. Carney, 66 Ohio St. 3d 376, 613 N.E.2d 183, 188, 82 Ed. Law Rep. 1181 (1993); see also 2 Corbin on Contracts § 58.5.

[22]See Restatement Second, Contracts § 356 (1981); U.C.C. § 2-718 (1977).

[23]See, e.g., Jaquith v. Hudson, 5 Mich. 123, 1858 WL 2314 (1858); Condon v. Kemper, 47 Kan. 126, 27 P. 829 (1891); 2 Corbin on Contracts § 58.5 ("[T]he courts in nearly all these cases profess to be construing the contract with reference to the intention of the parties . . . yet, it is obvious from these cases, that wherever it has appeared to the court . . . that the sum was clearly too large for just compensation, here, while they will allow any form of words, even those expressing the direct contrary, to indicate the intent to make it a penalty, yet no form of words, no force of language, is competent to the expression of the opposite intent.").

[24]2 Corbin on Contracts § 58.21.

[25]McQueen, Rains & Tresch, LLP v. Citgo Petroleum Corp., 2008 OK 66, 195 P.3d 35, 46 (Okla. 2008); Orr v. Goodwin, 157 N.H. 511, 953 A.2d 1190, 1194 (2008); Raisin Memorial Trust v. Casey, 2008 ME 63, 945 A.2d 1211, 1215 (Me. 2008); see, generally, Corbin on Contracts § 58.5.

[26]Courts have said that the law of 27 states follows the "single look" approach. See, e.g., Williwaw Lodge v. Locke, 601 P.2d 236, 239 (Alaska 1979); Pima Sav. and Loan Ass'n v. Rampello, 168 Ariz. 297, 812 P.2d 1115, 1118 (Ct. App. Div. 2 1991); Alley v. Rodgers, 269 Ark. 262, 599 S.W.2d 739, 741 (1980); Rohauer v. Little, 736 P.2d 403, 410 (Colo. 1987); Hanson Development Co. v. East Great Plains Shopping Center, Inc., 195 Conn. 60, 485 A.2d 1296, 1300 (1985); Brazen v. Bell Atlantic Corp., 695 A.2d 43, 48 (Del. 1997); District Cablevision Ltd. Partnership v. Bassin, 828 A.2d 714, 724, 51 U.C.C. Rep. Serv.

a retrospective test for determining the reasonableness of the stipulated formula, where it is judged against the party's actual damages caused by the breach.[27]

In California, the timing issue is controlled by statute, which codifies the single look approach, requiring that liquidated damages provisions be reasonable "under the circumstances existing

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2d 149 (D.C. 2003); Lefemine v. Baron, 573 So. 2d 326, 329 (Fla. 1991); Fickling and Walker Co. v. Giddens Const. Co., Inc., 258 Ga. 891, 376 S.E.2d 655, 660 (1989); Carrothers Const. Co., L.L.C. v. City of South Hutchinson, 288 Kan. 743, 207 P.3d 231, 242 (2009); Kelly v. Marx, 428 Mass. 877, 705 N.E.2d 1114, 1117 (1999); Brignull v. Albert, 666 A.2d 82, 84, 11 I.E.R. Cas. (BNA) 319 (Me. 1995); Barrie School v. Patch, 401 Md. 497, 933 A.2d 382, 390, 225 Ed. Law Rep. 973 (2007); Solomon v. Department of State Highways and Transp., 131 Mich. App. 479, 345 N.W.2d 717, 719 (1984); Frank v. Jansen, 303 Minn. 86, 226 N.W.2d 739, 743 (1975); Board of Trustees of State Institutions of Higher Learning v. Johnson, 507 So. 2d 887, 890, 40 Ed. Law Rep. 592 (Miss. 1987); Kuczynski v. Intensive Maintenance Care, Inc., 48 S.W.3d 55, 57 (Mo. Ct. App. E.D. 2001); Gruschus v. C. R. Davis Contracting Co., 75 N.M. 649, 409 P.2d 500, 504, 2 U.C.C. Rep. Serv. 1080 (1965); JMD Holding Corp. v. Congress Financial Corp., 4 N.Y.3d 373, 795 N.Y.S.2d 502, 828 N.E.2d 604, 609 (2005); Fisher v. Schmeling, 520 N.W.2d 820, 822 (N.D. 1994); Sun Ridge Investors, Ltd. v. Parker, 1998 OK 22, 956 P.2d 876, 878 (Okla. 1998); Safari, Inc. v. Verdoorn, 446 N.W.2d 44, 46 (S.D. 1989); Guiliano v. Cleo, Inc., 995 S.W.2d 88, 100, 16 I.E.R. Cas. (BNA) 1015, 139 Lab. Cas. (CCH) P 58713 (Tenn. 1999); Woodhaven Apartments v. Washington, 942 P.2d 918, 921 (Utah 1997); Brooks v. Bankson, 248 Va. 197, 445 S.E.2d 473, 479 (1994); Renaudette v. Barrett Trucking Co., Inc., 167 Vt. 634, 712 A.2d 387, 388 (1998); Watson v. Ingram, 124 Wash. 2d 845, 881 P.2d 247, 250 (1994).

[27]Courts have said that the law of 17 states follows the "second look" approach. See, e.g., Thanksgiving Tower Partners v. Anros Thanksgiving Partners, 64 F.3d 227, 232 (5th Cir. 1995) (applying Texas law); Yockey v. Horn, 880 F.2d 945, 953, 14 Fed. R. Serv. 3d 217 (7th Cir. 1989) (applying Illinois law); Southpace Properties, Inc. v. Acquisition Group, 5 F.3d 500, 505 (11th Cir. 1993) (applying Alabama law); McEnroe v. Morgan, 106 Idaho 326, 678 P.2d 595, 600 (Ct. App. 1984); Rohlin Const. Co., Inc. v. City of Hinton, 476 N.W.2d 78, 80 (Iowa 1991); Mattingly Bridge Co., Inc. v. Holloway & Son Const. Co., 694 S.W.2d 702, 705 (Ky. 1985); Kozlik v. Emelco, Inc., 240 Neb. 525, 483 N.W.2d 114, 121, 127 Lab. Cas. (CCH) P 57599 (1992); Mason v. Fakhimi, 109 Nev. 1153, 865 P.2d 333, 335 (1993); Shallow Brook Associates v. Dube, 135 N.H. 40, 599 A.2d 132, 137 (1991); Wasserman's Inc. v. Township of Middletown, 137 N.J. 238, 645 A.2d 100, 107 (1994); Knutton v. Cofield, 273 N.C. 355, 160 S.E.2d 29, 34 (1968); Lake Ridge Academy v. Carney, 66 Ohio St. 3d 376, 613 N.E.2d 183, 188, 82 Ed. Law Rep. 1181 (1993); Illingworth v. Bushong, 297 Or. 675, 688 P.2d 379, 390, 39 U.C.C. Rep. Serv. 903 (1984) (disapproved of on other grounds by, Ditommaso Realty, Inc. v. Moak Motorcycles, Inc., 309 Or. 190, 785 P.2d 343 (1990)); Phillips v. Phillips, 820 S.W.2d 785, 788 (Tex. 1991); Wheeling Clinic v. Van Pelt, 192 W. Va. 620, 453 S.E.2d 603, 609 (1994); Koenings v. Joseph Schlitz Brewing Co., 126 Wis. 2d 349, 377 N.W.2d 593, 600 (1985); Jessen v. Jessen, 810 P.2d 987, 990 (Wyo. 1991).

at the time the contract was made."[28] Louisiana similarly allows recovery of stipulated damages without requiring any proof of actual damages.[29] Georgia law permits liquidated damages without stipulating how the enforceability of such provisions should be determined.[30]

A. The "Single Look" Model

The "single look" model represents the traditional view held by courts. Under this approach, an enforceable liquidated damages provision must be a "genuine pre-estimate by the parties of a future breach of the contract."[31] The parties are required to look forward to the anticipated actual loss in determining the stipulated damages instead of operating "with the benefit of hindsight."[32] This view was set forth in the Restatement First, and the approach appears to have been nearly uniform in the period following its publication.[33]

The primary rationale offered by courts adopting the single look approach is that it is rooted in basic notions of fairness and

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[28]Cal. Civ. Code § 1671(b); see, e.g., Irwin v. Mascott, 96 F. Supp. 2d 968 (N.D. Cal. 1999); Better Food Markets v. American Dist. Tel. Co., 40 Cal. 2d 179, 253 P.2d 10, 14, 42 A.L.R.2d 580 (1953).

[29]La. Civ. Code Ann. art. 2005, 2009 (2008); see, e.g., Utley-James of Louisiana, Inc. v. State, Div. of Admin., Dept. of Facility Planning and Control, 671 So. 2d 473, 476 (La. Ct. App. 1st Cir. 1995); Southern Const. Co. v. Housing Authority of City of Opelousas, 250 La. 569, 197 So. 2d 628, 632 (1967). A court may modify liquidated damages, however, if they are "so manifestly unreasonable as to be contrary to public policy." La. Civ. Code Ann. art. 2012.

[30]See Ga. Code Ann. § 13-6-7 (2008); see, e.g., National Emergency Services, Inc. v. Wetherby, 217 Ga. App. 42, 456 S.E.2d 639, 641 (1995); Southeastern Land Fund, Inc. v. Real Estate World, Inc., 237 Ga. 227, 227 S.E.2d 340, 343 (1976).

[31]2 Corbin on Contracts § 58.6; see, e.g., Banta v. Stamford Motor Co., 89 Conn. 51, 92 A. 665 (1914) (disapproved of on other grounds by, Norwalk Door Closer Co. v. Eagle Lock & Screw Co., 153 Conn. 681, 220 A.2d 263 (1966)); Bailey v. Manufacturers' Lumber Co., 224 F. 806 (S.D. N.Y. 1915) (Hand, J.).

[32]24 Williston on Contracts § 65.17; Carrothers Const. Co., L.L.C. v. City of South Hutchinson, 288 Kan. 743, 207 P.3d 231, 242 (2009); Kelly v. Marx, 428 Mass. 877, 705 N.E.2d 1114, 1117 (1999); Brignull v. Albert, 666 A.2d 82, 84, 11 I.E.R. Cas. (BNA) 319 (Me. 1995); Barrie School v. Patch, 401 Md. 497, 933 A.2d 382, 390, 225 Ed. Law Rep. 973 (2007).

[33]See Restatement First, Contracts § 339 (stating that liquidated damages clauses are enforceable to the extent that they contain a "reasonable forecast" of just compensation); McCormick, Damages § 150, at 609; Perkins v. Spencer, 121 Utah 468, 243 P.2d 446 (1952).

freedom of contract.[34] Parties entering into liquidated damages agreements take a "calculated risk," and courts are loath to upset the parties' negotiated terms.[35] As Oliver Wendell Holmes wrote on this subject over a century ago, the "proper course is to enforce contracts according to their plain meaning and not to undertake to be wiser than the parties."[36] Holmes concluded that "when parties say that a sum is payable as liquidated damages they will be taken to mean what they say and will be held to their word."[37]

Promoters of the single look approach also reason that it promotes efficiency by resolving damages disputes without forcing the parties to litigate the issue of actual damages.[38] This line of argument often ties back to the requirement that liquidated damages are enforceable only when damages are uncertain in amount or difficult to prove. If that is the case, the argument goes, then proving up actual damages is even more unattractive.[39]

In addition, the single-look adherents argue that their model promotes the definitional purpose of liquidating damages in the first place: avoiding the cost and time spent on litigation over damages.[40] The single-look approach allows parties to "avoid the uncertainty, delay, and expense of litigation."[41] One commentator has noted that consideration of "actual damages would promote and prolong litigation, which is presumably what the parties sought to avoid by including the liquidated damages provision in

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[34]Guiliano v. Cleo, Inc., 995 S.W.2d 88, 100, 16 I.E.R. Cas. (BNA) 1015, 139 Lab. Cas. (CCH) P 58713 (Tenn. 1999) ("[W]e conclude that the prospective approach is the better rule based upon the consideration it affords to the intentions of the parties and to the freedom to contract."); see also Arrowhead School Dist. No. 75, Park County v. Klyap, 2003 MT 294, 318 Mont. 103, 79 P.3d 250, 256, 182 Ed. Law Rep. 915, 20 I.E.R. Cas. (BNA) 872 (2003) ("The fundamental tenet of modern contract law is freedom of contract . . .."); District Cablevision Ltd. Partnership v. Bassin, 828 A.2d 714, 724, 51 U.C.C. Rep. Serv. 2d 149 (D.C. 2003); Kelly, 705 N.E.2d at 1117.

[35]See Southwest Engineering Co. v. U.S., 341 F.2d 998, 1003 (8th Cir. 1965); Kelly, 705 N.E.2d at 1117.

[36]Guerin v. Stacey, 175 Mass. 595, 56 N.E. 892, 892 (1900) (Holmes, C.J.); see also Kelly, 705 N.E.2d at 1117; Jones v. Stevens, 112 Ohio St. 43, 3 Ohio L. Abs. 164, 146 N.E. 894, 897–898 (1925).

[37]Guerin, 56 N.E. at 892.

[38]Dist. Cablevision, 828 A.2d at 724; Kelly, 705 N.E.2d at 1117.

[39]Guiliano, 995 S.W.2d at 100.

[40]Kelly, 705 N.E.2d at 1117; Guiliano, 995 S.W.2d at 100; Dist. Cablevision, 828 A.2d at 724.

[41]Hoffar and Ewald, supra note 15, at 194.

the first place."[42] The Tennessee Supreme Court has expressed the opinion that it is fundamentally "unfair" to require a "nonbreaching party to prove actual damages in cases where the parties agreed in advance to a liquidated damages provision."[43]

B. The "Second Look" Model

Implementing the second look model, courts examine the reasonableness of stipulated damages by looking backward from the actual damages caused by the breach.[44] Courts adopting this approach often cite the Restatement Second, Contracts and the Uniform Commercial Code as support for considering actual damages.[45] The Restatement Second provides that damages must be reasonable in light of "the anticipated *or actual loss* caused by the breach."[46] It states that reasonableness is determined in part by the relationship between the liquidated damages and "the actual loss that has resulted from the particular breach."[47] The Restatement introduces an illustration that is similar to the concert hall hypothetical. Under the illustration, A contracts to build a grandstand at a racetrack for B, with $1,000 a day in liquidated damages provided for each day of delay.[48] Under the first iteration, completion of the grandstand is delayed by 10 days. The Restatement explains that if "$1,000 is not unreasonable in light of the anticipated loss and the actual loss to B is difficult to prove," A's promise to pay liquidated damages is not a penalty and therefore is enforceable.[49] Under the second iteration, however, B is delayed by a month in opening his racetrack because of licensing issues. In this situation, A's delayed perfor-

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[42]Hoffar and Ewald, supra note 15, at 194.

[43]Guiliano, 995 S.W.2d at 100; see, e.g., Kelly, 705 N.E.2d at 1117; Dist. Cablevision, 828 A.2d at 724.

[44]3 Farnsworth on Contracts § 12.18; 11 Corbin on Contracts § 58.6 (2005).

[45]For cases citing the Restatement Second and the Uniform Commercial Code in support of the second look model, see Wasserman's Inc. v. Township of Middletown, 137 N.J. 238, 645 A.2d 100, 107 (1994); Illingworth v. Bushong, 297 Or. 675, 688 P.2d 379, 39 U.C.C. Rep. Serv. 903 (1984) (disapproved of on other grounds by, Ditommaso Realty, Inc. v. Moak Motorcycles, Inc., 309 Or. 190, 785 P.2d 343 (1990)); MetLife Capital Financial Corp. v. Washington Ave. Associates L.P., 159 N.J. 484, 732 A.2d 493 (1999); Nohe v. Roblyn Development Corp., 296 N.J. Super. 172, 686 A.2d 382, 384 (App. Div. 1997).

[46]Restatement Second, Contracts § 356(1).

[47]Restatement Second, Contracts § 356(1) comment b.

[48]Restatement Second, Contracts § 356(1) comment b, illus. 3.

[49]Restatement Second, Contracts § 356(1) comment b, illus. 3.

mance of 10 days caused B "no loss at all" and enforcement of the liquidated damages would constitute a penalty.[50]

The Uniform Commercial Code, similarly, provides that damages can be liquidated by agreement only where they are "reasonable in 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."[51]

The second look courts typically note that the parties' freedom to contract must be balanced against an important, competing principle: that the private remedy employed in a liquidated damages clause does not stray too far from the rule that only compensatory contract damages may be enforced.[52] In addition to citing the Restatement Second and the Uniform Commercial Code as support for looking back to the actual damages incurred from the breach, these courts also point to the simple notion that "hindsight is frequently better than foresight," and thus courts cannot help but be influenced by its knowledge of subsequent events.[53] In this way, then, actual damages "reflect on the reasonableness of the parties' prediction of damages."[54]

There may be legitimate criticisms levied at the second look model. The model, however, is not designed to offer a panacea for all problems afflicting contract damages law. Instead, it offers a solution to the narrow problem of delay damages in construction cases. In this context, the second look model is the *only* possible way to temper the possibility of windfalls flowing to owners, a result that is contrary to the fundamental principles underlying contract damages.

III. Apology for the Look Back Approach

We propose that courts take a "look back" to actual damages in

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[50]Restatement Second, Contracts § 356(1) comment b, illus. 4.

[51]U.C.C. § 2-718(1); see, e.g., Wasserman's Inc. v. Township of Middletown, 137 N.J. 238, 645 A.2d 100, 107 (1994); Illingworth v. Bushong, 297 Or. 675, 688 P.2d 379, 39 U.C.C. Rep. Serv. 903 (1984) (disapproved of on other grounds by, Ditommaso Realty, Inc. v. Moak Motorcycles, Inc., 309 Or. 190, 785 P.2d 343 (1990)); MetLife Capital Financial Corp. v. Washington Ave. Associates L.P., 159 N.J. 484, 732 A.2d 493 (1999); Nohe v. Roblyn Development Corp., 296 N.J. Super. 172, 686 A.2d 382, 384 (App. Div. 1997).

[52]See, e.g., Wassenaar v. Panos, 111 Wis. 2d 518, 331 N.W.2d 357, 362, 40 A.L.R.4th 266 (1983); Wasserman's Inc. v. Township of Middletown, 137 N.J. 238, 645 A.2d 100, 106 (1994).

[53]Wassenaar, 331 N.W.2d at 364; Wasserman's, 645 A.2d at 107; see also 11 Corbin on Contracts § 58.11 (2005) ("[T]he court cannot help but be influenced by its knowledge of subsequent events.").

[54]Wasserman's, 645 A.2d at 107.

those cases where the owner has taken occupancy of the property without any sort of impairment of the owner's ability to use the property for its beneficial purpose.[55] We suggest that courts and arbitrators first use a "triggering" mechanism to determine whether a second look is necessary. As a starting point, we propose that fact-finders assess the scope of the actual damages incurred and how they compare to the liquidated damages amount. If the liquidated sum bears no "reasonable relationship" to the actual damages alleged by the plaintiff to have been incurred, then a full look back is necessary. If, after looking back with the benefit of hindsight, the fact-finder determines that no actual damages were incurred (or the amount of those damages is minimal), and the facility can still be used for all or nearly all of its intended revenue production, then the liquidated damages provision should be deemed a penalty. As such, the liquidated damages clause does not contain a genuine pre-estimate of compensatory damages and should not be enforced.

Our proposal calls for courts and arbitrators to adopt a uniform and consistent standard that honors the universal maxim prohibiting recovery of penalties that are disguised as contract damages. The model rule developed here is mindful of the parties' freedom to contract but also attentive to other guiding legal principles that caution against pure deference to the parties' wishes.[56] Our model is influenced by the kind of balance described by the Wisconsin Supreme Court:

> Public law, not private law, ordinarily defines the remedies of the parties. Stipulated damages are an exception to this rule. Stipulated damages allow private parties to perform the judicial function of providing the remedy in breach of contract cases, namely, compensation of the nonbreaching party, and courts must ensure

[55] We use "owners" here only because they are typically the parties who benefit from liquidated damages clauses in construction contracts.

[56] Moreover, we believe that adoption of our proposed model will likely lead parties to become more reasonable in drafting their contracts. Just as "baseball arbitration" forces opposing parties to move to middle ground, see Roger I. Abrams, 6 U. Chi. L. Sch. Roundtable 55, 55 (1999), widespread adoption of the look back model would cause parties to move to a more reasonable position when it comes to drafting liquidated damages provisions. As it stands now, owners anticipating the majority single look approach have everything to gain (in the form of potential windfalls) and nothing to risk (in the form of judicial oversight of their drafted liquidated damages clauses). With a renewed oversight of the reasonableness of liquidated damages provisions, owners and builders can meet on more reasonable ground, and many of the problems that arise in determining whether liquidated damages are "reasonable" may be avoided.

that the private remedy does not stray too far from the legal principle of allowing compensatory damages.[57]

A. "Trigger" Mechanism

The "trigger" mechanism is a critical step in the rule that we propose. If courts automatically proceed to a look back, there is a risk that principles of freedom of contract will yield to judicial second-guessing of contract terms. Notwithstanding that risk, there comes a point where blind deference to freedom of contract should yield to a reasonable level of scrutiny. We propose the following threshold inquiry as a cautionary trigger before implementing our look back model.

First, the owner must have taken beneficial occupancy of the property. That is, the property can be used for its primary beneficial purpose, *i.e.*, to produce revenue. That does not mean that there are no "time-related" damages, as discussed above, but that any time-related damages are not the type of damages that have a significant impact on beneficial occupancy. In the concert hall hypothetical, for example, time-related damages exist. There is exposed wiring, manuals yet to be delivered, and a faulty HVAC system in part of the concert hall even after the date by which substantial completion was required in the contract. These defects are time-related damages because the contract language linked their completion to the "substantial completion," but the concert hall is still operational and the owner can still hold the scheduled revenue-producing events.

The only true delay damages in the hypothetical stem from the builder's failure to finish the mezzanine seating level in time for the scheduled performances. Assuming that this accounts for 10% of the concert hall's seating, 10% of the hall's revenue will not be generated for the performances held while the mezzanine remains unfinished. In other words, the hall's owners can only receive 90% of their anticipated revenue for each performance date until the mezzanine is completed. In this case, there is a negative impact on the owner's beneficial occupancy of the hall due to the builder's delay, but it is not significant enough to prevent the revenue-producing events from being held. Therefore, the first factor in our triggering mechanism is satisfied.

The second step requires an analysis of the relationship between the amount of liquidated damages and the amount of actual damages incurred. Our model borrows from the United States Supreme Court's case law addressing the constitutionality

[57]Wassenaar v. Panos, 111 Wis. 2d 518, 331 N.W.2d 357, 40 A.L.R.4th 266 (1983).

of punitive damages.[58] We do not advocate a particular break point or ratio at which liquidated damages become suspect. Rather, we think that, as a practical matter, there is a point at which the arbitrator or court should be able to readily determine that the liquidated damages requested by the owner bear no "reasonable relationship"[59] to the likely amount of actual damages incurred.

In the concert hall hypothetical, for example, the damages flowing from the construction defects, such as the exposed wiring and undelivered manuals, would likely only add up to a sum ranging in the thousands. The unfinished mezzanine, and the resulting loss to the owner of 10% of revenue, would still only generate a number that pales in comparison to the owner's claim for $7.3 million in liquidated damages. The owner in the hypothetical is trying to recover 100% of the liquidated damages when the facility is generating 90% of its intended revenue. This outcome is intuitively suspect. Such a preliminary analysis and balancing of claims and foreseeable recovery can produce reliable results. You won't "need a weatherman to know which way the wind blows."[60] Moreover, under our look back model, the fact-finder may take a full second look at actual damages only after the builder makes a *prima facie* showing that both of these triggering elements have been satisfied, whereupon the burden will be on the owner to then prove his recoverable damages.

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[58]See, e.g., Exxon Shipping Co. v. Baker, 128 S. Ct. 2605, 2627, 171 L. Ed. 2d 570, 66 Env't. Rep. Cas. (BNA) 1545, 2008 A.M.C. 1521 (2008); State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408, 123 S. Ct. 1513, 155 L. Ed. 2d 585, Prod. Liab. Rep. (CCH) P 16805, 60 Fed. R. Evid. Serv. 1349, 1 A.L.R. Fed. 2d 739 (2003); BMW of North America, Inc. v. Gore, 517 U.S. 559, 580, 116 S. Ct. 1589, 134 L. Ed. 2d 809 (1996); TXO Production Corp. v. Alliance Resources Corp., 509 U.S. 443, 454, 113 S. Ct. 2711, 125 L. Ed. 2d 366, 61 Empl. Prac. Dec. (CCH) P 42321 (1993).

[59]Gore, 517 U.S. at 580 ("The second and perhaps most commonly cited indicium of an unreasonable or excessive punitive damages award is its ratio to the actual harm inflicted on the plaintiff. The principle that exemplary damages must bear a 'reasonable relationship' to compensatory damages has a long pedigree.") (internal citations omitted).

[60]Dylan, Subterranean Homesick Blues, on Bringing It All Back Home (Columbia Records 1965).

B. The Look Back Model Avoids Windfalls

Our look back model is preferable to the single look model because it presents a solution to the problem of windfalls.[61] The single look model can produce results that violate the principle that contract damages should be compensatory and not punitive.[62] The single look approach accepts the occasional windfall as a sacrifice to the principles of "freedom of contract." However, windfalls that depart radically from foreseeable and actual compensatory contract damages fly in the face of bargained-for exchanges[63] and should not be sanctioned by general reference to platitudes of contract law.

What practical harm arises from looking back from the vantage point of the actual consequences of a breach? Our model does not propose that fact-finders freely rewrite the terms to which parties have agreed. To the contrary, it asks courts to look back only in the limited cases in which a builder has made a *prima facie* showing that a look back is rationally based on actual circumstances. Even then, it interjects only where a windfall may run to owners because no significant, true delay damages actually exist. In the introductory hypothetical, for example, the owner of the concert

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[61]Some courts have addressed the situation in which a liquidated damages provision serves as a cap on a party's relief by precluding that party from proving up actual damages in excess of the liquidated amount. See, e.g., Fisher v. Schmeling, 520 N.W.2d 820, 824 (N.D. 1994) ("Regardless of the amount of actual damages incurred, the district court properly determined that the parties are bound by their stipulation."); Bruner & O'Connor on Construction Law § 19:52.64. In those cases where the stipulated damages are too low in light of the actual damages incurred, most courts treat the liquidated damages clause as capping that party's relief at the stipulated amount (almost as if the clause is a limitation of liability provision). See, e.g., Blue Mountain Mushroom Co., Inc. v. Monterey Mushroom, Inc., 246 F. Supp. 2d 394, 400 (E.D. Pa. 2002) (holding that Pennsylvania law prevents parties from recovering actual damages that exceed the liquidated damages amount).

Consistent with our proposed approach, however, we would permit courts to take a look back at the reasonableness of the liquidated damages amount, provided that the owner made a showing that the converse of our triggering mechanism is satisfied. Simply put, our approach adequately confronts the inequities presented by this rare situation as well.

[62]See Restatement Second, Contracts § 356 comment a ("The central objective behind the system of contract remedies is compensatory, not punitive. Punishment of a promisor for having broken his promise has no justification on either economic or other grounds and a term providing such a penalty is unenforceable on grounds of public policy.").

[63]Hoffar and Ewald, supra note 15, at 195 ("The policy against forfeiture is based in part upon the basic principles underlying compensatory damages, as the purpose of contract damages is to place the non-breaching party in no better position as it would have been in had the breach not occurred.").

hall is placed in a decidedly better position if liquidated damages are enforced. Even assuming some true delay damages (like the unfinished mezzanine), the owner is able to take occupancy of the structure and generate 90% of the intended revenue. The other remaining unfinished items may mean that the owner has received less at a certain point in time than he bargained for. However, if these defects are corrected by the builder or negotiated away by the parties, then no actual damages remain. The owner's recovery of $20,000 a day is nothing but a pure penalty.

The dispute involving the baseball stadium in Washington, D.C. presents another example of the dangers of windfalls. Blind adherence to the single look model under those facts would have allowed the team's owners to reap a substantial windfall. The stadium held all of its scheduled revenue-producing events without any delay or interruption. Moreover, the team's owners did so without any encountering any sort of fan unhappiness with their still "incomplete" stadium. In fact, by all accounts, the opening of the new stadium was an all-around hit with the fans (notwithstanding the quality of baseball played there). Despite these facts, and even assuming that the contractually defined "substantial completion" had not occurred, a single look court would have no choice but to award liquidated damages where no damages were ever suffered.[64]

C. Avoiding a Legal Fiction

Another important rationale supporting the look back model is that by considering the facts as they actually exist, courts and arbitrators can more easily assess the reasonableness of the liq-

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[64]The Massachusetts Supreme Judicial Court has attempted to define away the problem of "undue windfalls" in the context of a party seeking liquidated damages who suffered no actual loss. See Kelly v. Marx, 428 Mass. 877, 705 N.E.2d 1114, 1117 (1999). The court sought to work around the windfall problem by classifying the liquidated damages as an amount flowing from an "agreement between the parties," rather than akin to "damages resolved by a court examining post-breach circumstances." Kelly v. Marx, 428 Mass. 877, 705 N.E.2d 1114, 1117 (1999). In this court's view, the "parties agreed to the extent of their damages" when they agreed on a liquidated damages clause. Kelly v. Marx, 428 Mass. 877, 705 N.E.2d 1114, 1117 (1999). This approach, however, serves only to further divorce liquidated damages from their foundation in contract damages law. By treating liquidated damages clauses as agreements not providing for contract "damages," the Massachusetts court runs the risk of ending all judicial oversight of such agreements. Under this approach of complete deference to the parties' freedom of contract, the parties would be able to agree to any amount of damages.

uidated damages provision.[65] The Wisconsin Supreme Court got it right when it reasoned that, regardless of a court's chosen approach, "the cases demonstrate that the facts available at trial significantly affect the courts' determination of the reasonableness of the stipulated damages clause."[66] This is precisely why even the Restatement First, which advocated a single look approach, permitted consideration of actual damages when the breach in fact "cause[d] no harm at all."[67] The disparity between the liquidated damages amount and the actual damages incurred can clearly demonstrate that the "amount chosen was in fact unreasonable at the time of contracting."[68]

Courts adhering to the single look model have erroneously treated this issue as if nothing can be gained from looking backward from the point of the breach.[69] However, both the Restatement's grandstand fact pattern and common sense dictate to the contrary. The parties to the contract for the concert hall, for example, certainly intended that the liquidated damages clause was supposed to redress damages caused by events having to rescheduled, cancelled, or moved to another venue. When nothing remotely akin to that occurs, awarding the full liquidated damages amount is simply preposterous.[70]

The single look approach forces courts and arbitrators to ignore what really happens and instead assumes a worst-case scenario

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[65]See Shallow Brook Associates v. Dube, 135 N.H. 40, 599 A.2d 132, 137 (1991); Wasserman's Inc. v. Township of Middletown, 137 N.J. 238, 645 A.2d 100, 107 (1994).

[66]Wassenaar v. Panos, 111 Wis. 2d 518, 331 N.W.2d 357, 364, 40 A.L.R.4th 266 (1983); see also 11 Corbin on Contracts § 58.11 (2005) ("[T]he court cannot help but be influenced by its knowledge of subsequent events.").

[67]Restatement First, Contracts § 339 comment e (1932).

[68]24 Williston on Contracts § 65:17; see, e.g., Renaudette v. Barrett Trucking Co., Inc., 167 Vt. 634, 712 A.2d 387, 389 (1998); Mattingly Bridge Co., Inc. v. Holloway & Son Const. Co., 694 S.W.2d 702, 705 (Ky. 1985).

[69]The Supreme Judicial Court of Massachusetts, for example, has concluded that "the 'second look' reveals nothing that the parties had not contemplated when they entered their contract." Kelly, 705 N.E.2d at 1117 (internal quotation omitted).

[70]In the Restatement Second's example of a contract to construct a race track grandstand where the owner is prevented from opening due to failure to obtain a license, the single look approach would require the finder of fact to ignore the events that occurred subsequent to contract negotiation. See Restatement Second, Contracts § 356 illus. 4. Thus, that the race track could not have opened even if the grandstand was complete is simply irrelevant under the single look approach. In this situation, enforcing the daily liquidated damages award provides a windfall to the race track's owners.

to support an award.[71] "But the *might-have-been* is but boggy ground to build on."[72] The second look model ignores the might-have-been in favor of reality.[73]

What happens if a fact-finder employing this proposed model determines that the amount of liquidated damages is unreasonable? Our model does not require striking the liquidated damages clause entirely. Instead, it encourages courts and arbitrators to apply equitable principles and to fashion a reasonable recovery where warranted. In the concert hall hypothetical, for example, the court or arbitrator could reject the $20,000 a day liquidated sum while still awarding the actual damages suffered. A better approach would be for the fact-finder to focus on the true delay damages caused by the builder's failure to complete the mezzanine seating level and the owner's resulting inability to receive the full anticipated revenue from the project. Enforcing 100% of the liquidated damages in that scenario is patently unreasonable,

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[71]See 11 Corbin on Contracts § 58.11 (2005) ("It is to be observed that hindsight is frequently better than foresight, and that, in passing judgment upon the honesty and genuineness of the pre-estimate made by the parties, the court cannot help but be influenced by its knowledge of subsequent events."); see also Nohe v. Roblyn Development Corp., 296 N.J. Super. 172, 686 A.2d 382, 384 (App. Div. 1997) (citing this statement from Corbin on Contracts).

[72]Melville, Billy Budd 57 (Harrison Hayford & Merton M. Sealts eds., Univ. of Chi. Press 1962) (1924).

[73]In addition, the claimed efficiency gained from the single look approach's avoidance of inquiring into actual damages is overstated. Unlike as its proponents claim, the single look approach is not an absolute bar into examining actual damages. As discussed above, some single look courts have considered the actual damages incurred as relevant to the amount of damages that could "reasonably have been expected when the contract was made." McCormick, Damages § 150, at 609 n.34. Additionally, both Restatements permitted admitting evidence of actual damages when the breach allegedly caused no harm at all. See Restatement First, Contracts § 339 comment e; Restatement Second, Contracts § 356 comment b ("If, to take an extreme case, it is clear that no loss at all has occurred, a provision fixing a substantial sum as damages is unenforceable."). Also, two prominent treatises discuss cases considering actual damages in hindsight because proving up damages (or the lack thereof) at that point presents no great difficulty. See 2 Corbin on Contracts § 58.11 (describing the cases permitting a look backwards when no injury occurred as a distinct line of cases deviating from the classical prospective rule); 3 Farnsworth on Contracts § 12.18; see, e.g., Nohe, 686 A.2d at 384; 301 Dahlgren Ltd. Partnership v. Board of Supervisors of King George County For and on Behalf of Dahlgren Sanitary Dist., 240 Va. 200, 396 S.E.2d 651, 653 (1990). As Julian Hoffar and Shelly Ewald have noted "even some jurisdictions that purport to adopt a prospective analysis, acknowledge that evidence of actual damages, is relevant evidence on the issue of whether the estimate of damages was reasonable." Hoffar and Ewald, supra note 15, at 193–194.

but awarding the owner 10% (or maybe as much as 20%) of the liquidated damages amount would likely be equitable. This approach is beneficial because it does not require owners to prove up with precision every miniscule item of actual damages. We understand that owners and builders agree to liquidated damages clauses to avoid just that sort of inconvenience, and thus our model permits fact-finders to look to equity to determine what should be done with the parties' stipulated amount. In this way, our look back approach is considerably more flexible than the single look approach. We do not let the breaching party off the hook by simply tossing out the liquidated damages and requiring the nonbreaching party to prove up each item of actual damages. We also do not permit windfalls to be awarded to nonbreaching parties.

IV. Conclusion

In sum, only our proposed model for looking back to actual damages can effectively confront the problem of undue windfalls—or what are really nothing more than unenforceable contract "penalties." Moreover, our model is attentive to the parties' freedom to contract, but preserves *real*, as opposed to *fictional*, contractual expectations. Thus, while our model allows parties to stipulate their damages in advance, it also ensures that the important legal principle that only compensatory damages will be enforced in contract law will continue to have meaning. Because reality always beats fiction, the second look model provides the better rule.