



UNC  
SCHOOL OF LAW

NORTH CAROLINA LAW REVIEW

---

Volume 44 | Number 4

Article 13

---

6-1-1966

## Damages -- Contractual Limitation of Liability

David A. Irvin

Follow this and additional works at: <http://scholarship.law.unc.edu/nclr>



Part of the [Law Commons](#)

---

### Recommended Citation

David A. Irvin, *Damages -- Contractual Limitation of Liability*, 44 N.C. L. REV. 1132 (1966).

Available at: <http://scholarship.law.unc.edu/nclr/vol44/iss4/13>

This Note is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Law Review by an authorized editor of Carolina Law Scholarship Repository. For more information, please contact [law\\_repository@unc.edu](mailto:law_repository@unc.edu).

The question of whether a speedy trial has been afforded a defendant is a determination that must be made on a case-by-case basis,<sup>33</sup> but it is important to provide a safeguard in advance where practicably possible so that this issue will not arise.

J. TROY SMITH, JR.

### Damages—Contractual Limitation of Liability

If a purchaser of real estate is required to put up a good faith deposit before the sale is confirmed, he may provide in the sales contract that if he fails to purchase the property, the deposit shall be forfeited to the seller as liquidated damages. If the purchaser does default, what damages will the seller be able to obtain if the property is later sold at such a low price that the difference between the original and second sale prices is greater than the amount of deposit that the buyer forfeited? A court has the following alternatives:<sup>1</sup>

(1) To treat the stipulated sum retained as liquidated damages and limit the plaintiff's (seller's) recovery to that amount regardless of whether the actual damages suffered were more or less. Designating the sum liquidated damages primarily benefits the plaintiff (seller) by entitling him to his pre-estimation of his probable damages upon a showing of the breach without the necessity of proving actual damages and incidentally benefits the defendant (buyer) by setting his minimum and maximum liability.

(2) To treat the stipulated sum retained as a penalty and allow the plaintiff (seller) to recover his provable actual damages sustained because of the breach. Designating the sum a penalty primarily benefits the defendant (buyer) by placing upon the plaintiff (seller) the additional burden of establishing his actual damages, which are almost always lower, and incidentally benefits the plaintiff (seller) by removing the maximum limit to liability of the defendant (buyer).

---

851, 852 (1933); N.C. GEN. STAT. §§ 1-176, -177 (1953), -175 (Supp. 1965). The requisite of good cause that a defendant must show to obtain a continuance apparently is not required in actual practice of a solicitor when he seeks a *nol. pros.* with leave.

<sup>33</sup> See note 26 *supra*.

<sup>1</sup> For a general discussion of these alternatives, see 5 WILLISTON, CONTRACTS §§ 781A, 790 (3d ed. 1961).

(3) To treat the stipulated sum retained as a contractual limitation of liability to an agreed maximum and allow the plaintiff (seller) to recover his actual damages proved up to but not in excess of the limitation. Designating the sum a contractual limitation of liability *exclusively* benefits the defendant (buyer) by setting his maximum liability in case of a breach, leaving actual damages in a lesser amount to be established by the plaintiff (seller).

These alternatives were recently illustrated in *City of Kinston v. Suddreth*.<sup>2</sup> There a buyer forfeited a 4000-dollar deposit when he failed to comply with his bid. When the property later sold at a 5000-dollar "loss," the seller sued the buyer for the 1000-dollar difference. The seller's position was that the contract provision was a penalty which the court would not enforce, thus permitting a recovery of actual damages. The buyer demurred on the ground that the seller could recover no more than the agreed amount which the parties denominated liquidated damages. The court sustained the defendant's demurrer by interpreting the contract provision as a valid contractual limitation of liability to an agreed maximum instead of a liquidated damage clause or a penalty clause.

Contractual limitations of liability are not innovations in North Carolina law. Although not favored and construed strictly, contracts exempting a party from liability for his own negligence have been upheld.<sup>3</sup> Moreover, contractual modifications of liability, that is, insurance limits in the event of intentional death, are valid.<sup>4</sup> If liability can be eliminated or modified, the parties to a contract ought to be able to limit their liability to an agreed maximum amount, leaving actual losses in a lesser amount to be determined by the ordinary rules and principles of damages. In fact, writers generally recognize the validity of contracts limiting liability,<sup>5</sup> and North Carolina, with the aid of a federal statute, has allowed a telegraph company to limit its liability in case of faulty transmis-

---

<sup>2</sup> 266 N.C. 618, 146 S.E.2d 660 (1966).

<sup>3</sup> Hall v. Sinclair Refining Co., 242 N.C. 707, 89 S.E.2d 396 (1955). Cf. Miller's Mut. Fire Ins. Ass'n v. Parker, 234 N.C. 20, 65 S.E.2d 341 (1951).

<sup>4</sup> Williford v. Southern Fire Ins. Co., 248 N.C. 549, 103 S.E.2d 804 (1958); Daily v. Washington Nat'l Ins. Co., 208 N.C. 817, 182 S.E. 332 (1935).

<sup>5</sup> E.g., 5 CORBIN, CONTRACTS § 1068 (1964); 5 WILLISTON, CONTRACTS § 781A (3d ed. 1961); RESTATEMENT, CONTRACTS § 339(1), comment g (1932).

sions.<sup>6</sup> The principal case stands with these decisions as a recognition of freedom of contract.

The importance of the decision, however, is that it establishes North Carolina as one of the few jurisdictions to consider an attempt to limit liability through a liquidated damage provision.<sup>7</sup> To call a liquidated damage clause a limitation of liability clause requires a willingness on the part of the court to interpret the contract because the two doctrines are inconsistent, differing both in intent and in effect.<sup>8</sup> A provision for liquidated damages is an attempt by the parties to pre-estimate the actual loss; if it is found to be valid,<sup>9</sup> the plaintiff must plead and prove only the breach. The stipulated amount is then awarded whether the actual loss is greater or less.<sup>10</sup> On the other hand, a limitation of liability clause is an attempt by one of the parties to limit his maximum liability; if it is valid,<sup>11</sup> the plaintiff must still plead and prove his damages after establishing a breach. If the actual damages are less than the limited amount, the plaintiff takes only the amount proved; if more, he takes the limited figure.<sup>12</sup>

Of course in construing a clause the parties' characterization of it in the contract is no more controlling than where courts have been called upon to construe a liquidated damage clause to be a penalty.<sup>13</sup>

<sup>6</sup> Compare *Meadows v. Postal Tel. & Cable Co.*, 173 N.C. 240, 91 S.E. 1009 (1917) with *Young v. Western Union Tel. Co.*, 168 N.C. 36, 84 S.E. 45 (1915).

<sup>7</sup> Fritz, "Underliquidated" Damages as Limitation of Liability, 33 TEXAS L. REV. 196 (1954).

<sup>8</sup> See authorities note 5 *supra*.

<sup>9</sup> Two tests are generally applied to determine the validity of a liquidated damages clause: if, judging from appearances at the time of making the contract, (1) the actual damages in case of breach are difficult to ascertain, and (2) the stipulated amount is reasonably proportional to the actual damages, the clause is generally valid.

47 IOWA L. REV. 964, 965-66 (1962).

<sup>10</sup> Compare *Better Food Mkts., Inc. v. American Dist. Tel. Co.*, 40 Cal. 2d 179, 253 P.2d 10 (1953) (less) with *Community Home Improvement Co. v. Turner*, 80 N.Y.S.2d 629 (1947) (greater).

<sup>11</sup> While most authorities agree that limitation clauses are generally valid, there are no broad guides comparable to the two tests used in establishing the validity of liquidated damages clauses. There appears to be a general willingness to allow parties to protect themselves by limiting their liability to a reasonable amount.

47 IOWA L. REV. 964, 967 (1962).

<sup>12</sup> *Western Union Co. v. Nestor*, 309 U.S. 582 (1940).

<sup>13</sup> A provision has been construed a limitation of liability even though designated "liquidated damages," *American Dist. Tel. Co. v. Roberts & Son*, 219 Ala. 595, 122 So. 837 (1929), and though designated a "penalty," *Cellulose Acetate Silk Co. v. Widnes Foundry*, [1933] A.C. 20 (H.L. 1932).

Rather, courts interpreting clauses dealing with the parties' remedial rights have looked to the entire agreement—its scope, purpose and subject matter.<sup>14</sup> In this manner courts have seized upon the situation of the parties and the clause's express language of limitation, that is, liability limited and fixed at a specified amount<sup>15</sup> or not liable beyond a specified amount,<sup>16</sup> to construe the clause as a limitation of liability even though the specified amount was designated as liquidated damages. Other courts, despite the ever-present dicta that an underestimation is just as condemned as an overestimation of damages and will not be enforced,<sup>17</sup> have upheld the stipulated sum, which was much less than the actual damages, as a valid liquidated damage clause.<sup>18</sup> To accomplish the same result achieved through a valid limitation of liability provision, these latter courts had to adopt the foresight point of view and fictionalize the probabilities as they must have appeared to the parties at the time they contracted.<sup>19</sup>

The North Carolina court definitely picked the firmer foundation to achieve the result desired. But in deciding that the provision of the defendant's contract was a valid limitation of liability, the court has taken the final step in formulating a rule for the defendant's (promisor's) bar.<sup>20</sup> The initial step is revealed in prior North Carolina decisions, which, in almost every instance where no actual damages existed<sup>21</sup> or the actual damages sustained were less than the stipulated amount,<sup>22</sup> the buyer has not been held to his promise even though the parties designated the sum liquidated damages. The courts in this state have been very receptive to the argument that the stipulated sum is not a reasonable pre-estimate of probable damages but is merely "a *punishment*, the threat of which is de-

---

<sup>14</sup> 5 STAN. L. REV. 822, 826 & n.17 (1953).

<sup>15</sup> American Dist. Tel. Co. v. Roberts & Son, 219 Ala. 595, 122 So. 837 (1929).

<sup>16</sup> Western Union Co. v. Nestor, 309 U.S. 582 (1940).

<sup>17</sup> See Fritz *supra* note 7, at 214.

<sup>18</sup> Atkinson v. Pacific Fire Extinguisher Co., 40 Cal. 2d 192, 253 P.2d 18 (1953); Better Food Mkts. v. American Dist. Tel. Co., 40 Cal. 2d 179, 253 P.2d 10 (1953). Cf. Stone, Sand & Gravel Co. v. United States, 234 U.S. 270 (1914); Owen v. Christopher, 144 Kan. 765, 62 P.2d 860 (1936).

<sup>19</sup> See note 7 *supra* at 217-18.

<sup>20</sup> 5 CORBIN, CONTRACTS § 1060 (1964); 5 STAN. L. REV. 822, 826-27 (1953).

<sup>21</sup> *E.g.*, Crawford v. Allen, 189 N.C. 434, 127 S.E. 521 (1925); Disosway v. Edwards, 134 N.C. 254, 46 S.E. 501 (1904).

<sup>22</sup> *E.g.*, Wheedon v. American Bonding & Trust Co., 128 N.C. 69, 38 S.E. 255 (1901); Thoroughgood v. Walker, 47 N.C. 16 (1854).

signed to prevent the breach, or as *security* . . . to insure that the person injured shall collect his actual damages."<sup>23</sup> In fact, there is authority to say that North Carolina would judge the clause from a hindsight point of view, in which the actual loss suffered will be regarded as of great, if not controlling, importance to the decision whether or not the clause was an acceptable attempt to estimate the loss in advance.<sup>24</sup> The *Suddreth* decision is certainly in keeping with the desire of the court to shield the defendant "from an absurd or oppressive claim which is entirely disproportionate to the actual damage he has caused,"<sup>25</sup> because with the limitation of liability interpretation, a plaintiff will never be able to recover more than his actual damages.

The next step in the evolution of the "defendant's rule" is to deny the ability of a plaintiff to assert affirmatively that the stipulated sum is unjust. Despite the apparent inequity, the court in the principal case indicates that the result of the case would be the same even if the plaintiff's contention that the clause is a penalty is accepted because the North Carolina measure of damages, where a liquidated damages clause is deemed a penalty, is the compensation for the actual loss, not exceeding the penalty named.<sup>26</sup> The court's authority for such a proposition is merely dictum,<sup>27</sup> and no North Carolina cases have been found following this rule. Moreover, the decisions allowing a recovery in excess of the stipulated amount of a performance bond, declared a penalty,<sup>28</sup> were not mentioned by the court in *Suddreth*.

In spite of this, the court in the principal case adopted a rule for the defendant that combines the past disfavor with a liquidated

---

<sup>23</sup> Definition of "penalty" contained in McCORMICK, DAMAGES § 146 (1935).

<sup>24</sup> See *Thoroughgood v. Walker*, 47 N.C. 16 (1854), where it was stated that "if the sum agreed on by the parties is to be construed liquidated damages, as the terms import, then the defendant will be bound to pay a greater sum for a less, which cannot be, as that, according to all the cases, is a penalty." *Id.* at 22.

<sup>25</sup> *City of Kinston v. Suddreth*, 266 N.C. 618, 620, 146 S.E.2d 660, 662 (1966).

<sup>26</sup> *Id.* at 621, 146 S.E.2d at 662.

<sup>27</sup> The dictum was taken from *Wheedon v. American Bonding & Trust Co.*, 128 N.C. 69, 71, 38 S.E. 255, 255 (1901), which involved actual damages that were less than the stipulated sum.

<sup>28</sup> *Peeler v. Peeler*, 202 N.C. 123, 162 S.E. 472 (1932); *Barber-Paschal Lumber Co. v. Boushall*, 168 N.C. 501, 84 S.E. 800 (1915); *Rhyne v. Rhyne*, 160 N.C. 559, 76 S.E. 469 (1912); *Gordon v. Brown*, 39 N.C. 399 (1846).

damages interpretation when the actual loss is less than the stipulated amount with a disfavor with a "true" penalty interpretation when the actual loss is greater than the stipulated amount. Even so, the upholding of a limitation of liability provision is of no real consequence if this is indeed what the parties contracted for. It is, however, of consequence when a court takes this final step for a defendant with the ease exhibited in *Suddreth*. For example, one of the justifications for construing a liquidated damages clause as a penalty is the rule of construction that the ambiguities of a contract will be construed against the responsible party.<sup>29</sup> Normally a liquidated damages clause is inserted by the plaintiff (promisee) to avoid litigation on the issue of damages. Here, the defendant-buyer (promisor) inserted the provision. The clause is also ambiguous since it contained no additional words of limitation on which other courts have placed such heavy reliance in construing a liquidated damages clause to be a limitation of liability clause.<sup>30</sup> And yet, the court interpreted the contract in the defendant's favor and stated that he "intended to limit the amount of damages which could be recovered against him in the event he did not purchase the property. Whatever the [plaintiff] may have intended, that was the effect of the contract which it accepted."<sup>31</sup> Moreover, the willingness on the part of the court to support its interpretation of the contract by stressing the intention of one party is inconsistent with prior cases dealing with modification and elimination of liability.<sup>32</sup> Such freedoms of contract have been upheld *only* with reservations, such as equality of bargaining position and notice of the limitation and its consequences to the promisee.<sup>33</sup> In the principal case, it appears that these reservations were replaced by the defendant's intent.

---

<sup>29</sup> 5 WILLISTON, CONTRACTS § 621 (3d ed. 1961).

<sup>30</sup> See notes 15 & 16 *supra*.

<sup>31</sup> 266 N.C. at 621, 146 S.E.2d at 663.

<sup>32</sup> See notes 3 & 4 *supra*.

<sup>33</sup> See *Miller's Mut. Fire Ins. Ass'n v. Parker*, 234 N.C. 20, 65 S.E.2d 341 (1951), indicating that contracts exempting a party from liability may or may not be enforced depending on the nature and subject matter of the contract, relation of the parties, presence or absence of equality of bargaining power and attendant circumstances. This is to say nothing of the clauses limiting liability that have been struck where a party tries to excuse a willful or gross breach of duty or excuse a public duty that are cited in 5 STAN. L. REV. 822, 825 (1953). Also see Note, 47 IOWA L. REV. 964 (1962), which recognizes the uncertainty of the enforceability of contractual limitations of liability and tries to articulate a standard for them with special emphasis on disclaimers in consumer goods sales under the Uniform Commercial Code.

Contractual limitations of liability have their place in the law as when the promisee accepts the additional risks and is compensated for them. But the freedom of contract should not exist for only one party to the contract.

DAVID A. IRVIN

### Domestic Relations—Voluntary Nonsuit in Custody Action

In a civil action in North Carolina the plaintiff may obtain a voluntary nonsuit if the defendant has not asserted some claim or cross-action arising out of the same transaction entitling him to affirmative relief.<sup>1</sup> In *Griffith v. Griffith*,<sup>2</sup> the North Carolina Supreme Court has held that the plaintiff should be allowed a nonsuit in a proceeding involving the custody of a child when the defendant does not answer the complaint.

The plaintiff instituted an action for alimony without divorce under section 50-16 of the General Statutes<sup>3</sup> and requested custody

---

<sup>1</sup> *E.g.*, *Ashley v. Jones*, 246 N.C. 442, 98 S.E.2d 667 (1957); *McLean v. McDonald*, 173 N.C. 429, 92 S.E. 148 (1917); *Francis & Brother v. W. J. & J. G. Edwards & Co.*, 77 N.C. 271 (1877). A counterclaim is defined by N.C. GEN. STAT. § 1-137 (1953) and is "broader in meaning than set-off, recoupment, or cross-action, and includes them all, and secures to defendant the full relief which a separate action at law, or a bill in chancery, or a cross-bill would have secured on the same state of facts." *Aetna Life Ins. Co. v. Griffin*, 200 N.C. 251, 253, 156 S.E. 515, 516 (1931). The rule had a counterpart in equity where the plaintiff was not allowed to have his rule dismissed when the defendant claimed a set-off. *March v. Thomas*, 63 N.C. 87 (1868). The counterclaim must arise out of the same transaction as the plaintiff's cause of action in order to bar the nonsuit. *Olmsted v. Smith*, 133 N.C. 584, 45 S.E. 953 (1903). See generally 2 *McINTOSH, NORTH CAROLINA PRACTICE AND PROCEDURE* § 1645 (2d ed. 1956).

<sup>2</sup> 265 N.C. 521, 144 S.E.2d 589 (1965).

<sup>3</sup> In a proceeding instituted under this section, the plaintiff or the defendant may ask for custody of the children of said parties, either in the original pleadings or in a motion in the cause. Whereupon, the court may enter such orders in respect to said custody as might be entered upon a hearing on a writ of habeas corpus issued for the purpose of determining the custody of said children. Such request for custody of the children shall be in lieu of a petition for a writ of habeas corpus, but it shall be lawful for the custody of said children to be determined upon a writ of habeas corpus, provided the petition for said writ is filed prior to the filing of said pleadings or motion for such custody in the cause instituted under this section. N.C. GEN. STAT. § 50-16 (Supp. 1965). In addition to this statute, custody may be determined in North Carolina by way of habeas corpus proceedings when the parents are separated but not divorced under N.C. GEN. STAT. § 17-39 (1953); by habeas corpus proceedings generally under N.C. GEN.