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Remedies -- The High Price of Cotton and the Breaching Farmer: Liquidated Damages, Specific Performance and Other Remedies

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During the 1973 cotton crop year in the southeastern United States the price of cotton rose from approximately thirty cents per pound to approximately ninety cents per pound between the spring and fall. This was the fastest rise in more than a century. Consequently, many farmers who had entered into cotton sales contracts[1] in the spring breached or sought to avoid these contracts in the fall in order to sell their cotton on the open market. In the resulting lawsuits, many farmers defended on the ground that the liquidated damages clauses in their contracts provided purchasers with their sole remedy. There are two main issues in these cases—whether the liquidated damages clause is the exclusive remedy and, assuming a negative response to the first question, whether the buyers are entitled to either specific performance or actual damages.

One of the first of these so-called "cotton contract cases," *Carolinas Cotton Growers Association, Inc. v. Arnette*,[2] involved farmers who had signed marketing agreements with the plaintiff, an agricultural cooperative, in which the farmers agreed to sell and deliver to plaintiff all the cotton produced on specified acreage.[3] The marketing agreements were executed before the cotton crop was planted, and each contained a liquidated damages clause. Each of the defendants refused to deliver the cotton as contracted and some sold to third parties. The

1. These contracts are known in the trade as "forward contracts" because they are made in the spring at or before the planting of the cotton crop, and establish the price to be paid to the farmer for his cotton when it is harvested in the fall. Such contracts have become common in recent years because they allow the farmer to know in advance the price he will receive for his cotton. This knowledge benefits the farmer in two respects. He is able to determine in advance if it is economically wise for him to plant, cultivate and harvest his crop in light of the price he is to receive. Also, the farmer is relieved of the risk of loss in the event that cotton prices decrease prior to the time for harvest.

These forward contracting arrangements also have advantages for the ultimate, if not the immediate, purchaser, the textile manufacturer, because he knows the cost of his raw material six to eight months prior to harvest. Carolinas Cotton Growers Ass'n, Inc. v. Arnette, 371 F. Supp. 65 (D.S.C. 1974).

2. 371 F. Supp. 65 (D.S.C. 1974). *See also* Mitchell-Huntley Cotton Co. v. Lawson, 377 F. Supp. 661 (M.D. Ga. 1973).

3. These "forward contracts" usually cover all the cotton produced on specified acreage rather than a certain number of bales; therefore, they are output contracts. It should be noted, however, that the usual number of bales produced on a given farm is a fairly constant figure unless some unexpected natural disaster occurs. 371 F. Supp. at 66.

plaintiff sought specific performance and the defendants contended that the liquidated damages clause in the contract provided plaintiff with its exclusive remedy.

The court held that under the Uniform Commercial Code[4] liquidated damages were not the exclusive remedy available to plaintiff and that it was entitled to specific performance as provided by the South Carolina Cooperative Marketing Act.[5] This note will analyze the possible impact of *Arnette* with respect to similar cases now pending, particularly those in North Carolina.[6]

Analysis of the *Arnette* case must begin by considering the question of the applicability of the Uniform Commercial Code to "cotton contracts." Article Two of the U.C.C. applies to sales and other "transactions in goods."[7] In section 2-105(1) "goods" are defined to include "growing crops." Sections 2-501(1)(c) and 9-204(2)(a) clearly establish that crops are considered as growing once they are planted. Thus, a contract for the sale of a crop which is planted at the time the contract is made is a contract for the sale of goods.[8]

Although the *Arnette* court in applying the U.C.C. to the liquidated damages issue did not discuss the threshold question of whether the U.C.C. applies to a contract for the sale of *unplanted* crops, the language and purpose of section 2-105 support such an application. "Goods" are defined in the first sentence of section 2-105 (1) as "things . . . which are movable *at the time of identification* to the contract for sale. . . ."[9] In extending the definition of goods specifically to include "growing crops," the draftsmen intended that this status again be defined as of "the time of identification," not as of the time of the making of the contract. Since crops are not identified to the contract until they begin growing,[10] unplanted crops will be

4. UNIFORM COMMERCIAL CODE § 2-719(1)(b).
5. S.C. CODE ANN. § 12-973 (1962).
6. Even though *Arnette* is a South Carolina case, North Carolina courts have looked to cases in other states as a method of interpreting the Uniform Commercial Code, remembering that one of the purposes of the U.C.C. is "to make uniform the law among various jurisdictions." Evans v. W.B. Everett, Early & Winborne, Inc., 10 N.C. App. 435, 437, 179 S.E.2d 120, 122 (1971), *citing* N.C. GEN. STAT. § 25-1-102(2)(c) (1965).
7. UNIFORM COMMERCIAL CODE § 2-102.
8. *See, e.g.*, Exchange Nat'l Bank v. Alturas Packing Co., 269 So. 2d 733 (Fla. Dist. Ct. App. 1972) (citrus fruit); Barron v. Edwards, 45 Mich. App. 210, 206 N.W.2d 508 (1973) (sod); Azevedo v. Minister, 86 Nev. 576, 471 P.2d 661 (1970) (hay).
9. N.C. GEN. STAT. § 25-2-105(1) (1965) (emphasis added).
10. "In the absence of explicit agreement identification occurs . . . (c) when the crops are planted or otherwise become growing crops . . . ." UNIFORM COMMERCIAL CODE § 2-501(1)(c).

growing crops at the time of identification and are thus "goods."[11]

Under U.C.C. section 2-105(2), unplanted crops, like unproduced manufactured articles, are "future goods," for they are not yet in existence and identified to the contract. Official Comment Two to this section makes clear that contracts to sell future goods are covered by the U.C.C.

As noted previously, many, though not all, cotton sales contracts contain liquidated damages clauses.[12] The U.C.C. clearly answers the question of whether such clauses are presumed to be exclusive remedies. Section 2-719(1)(b) provides that resort to a contract remedy is optional unless expressly provided to be exclusive. Official Comment Two to this section further states that, if the parties intend a contract term to describe a sole remedy, "this must be clearly expressed." Together, these two provisions compel the conclusion that a contract remedy is not exclusive unless the agreement so specifies.[13]

Even if an agreement does not expressly make liquidated damages the sole remedy, thus permitting the injured party to seek an equitable remedy,[14] a valid liquidated damages clause apparently will preclude the injured party from seeking his actual damages. The general rule under pre-Code law was that a valid liquidated damages clause substituted the amount agreed upon for the actual damages resulting from the breach of the contract.[15] There is no compelling reason to believe that section 2-719(1)(b) alters that rule; it simply makes clear that

11. This interpretation is supported by the fact that it does not distinguish between crops and manufactured goods. Manufactured articles that have not been produced at the time the contract is made are "goods" under section 2-105(1) because they will be movable when they are identified to the contract. There is no policy reason for the Code to cover unproduced manufactured articles but to exclude unplanted crops. Moreover, it is too important and unusual a distinction to have been made without clearer delineation in the Code itself and without any explanation in the comments to the Code. *See* Mitchell-Huntley Cotton Co. v. Lawson, 377 F. Supp. 661 (M.D. Ga. 1973).

12. Such clauses are found most often in contracts involving marketing associations such as Carolinas Cotton Growers Association, Inc. Obviously, if there is no liquidated damages clause in the contract, the main issue will be whether the non-breaching plaintiff is entitled to specific performance, or some other equitable remedy, or to the recovery of his actual damages.

13. Carolinas Cotton Growers Ass'n, Inc. v. Arnette, 371 F. Supp. 65, 70 (D.S.C. 1974). *See* RESTATEMENT OF CONTRACTS § 378 (1932).

14. Such an equitable remedy might be specific performance or an injunction forbidding sales to third parties. UNIFORM COMMERCIAL CODE § 2-716(1).

15. *See, e.g.*, Quaile & Co. v. William Kelly Milling Co., 184 Ark. 717, 43 S.W.2d 369 (1931); Robbins v. Plant, 174 Ark. 639, 297 S.W. 1027 (1927); U-Haul Co. of N.C., Inc. v. Jones, 269 N.C. 284, 152 S.E.2d 65 (1967) (holding that a liquidated damages clause will not preclude an equitable remedy but does settle the amount of damages if there is a suit for such).

non-damage remedies are not precluded.[16] Furthermore, some courts have held that the U.C.C. allows the injured party to recover actual damages *if* liquidated damages have not been stipulated.[17] By inference, if liquidated damages *are* stipulated, the Code would not permit recovery of actual damages despite section 2-719(1)(b). Therefore, an injured party seeking damages is limited to the amount stipulated in the liquidated damages clause, unless he can show that the clause itself is invalid.

A liquidated damages clause must meet two requirements in order to be enforceable. First, the damages that the parties might reasonably anticipate from a breach must be incapable or very difficult of accurate estimation. Secondly, the amount stipulated must be either a reasonable estimate of the damages that would probably be caused by a breach or reasonably proportionate to the damages actually caused by the breach.[18]

Liquidated damages clauses are most frequently attacked on the theory that the damages stipulated are excessive and therefore constitute an unenforceable penalty.[19] In the recent cotton contract cases, the liquidated damages, if provided for, have been disproportionately *small*, especially if actual damages are to be measured by the market price-contract price differential. Some courts and authorities have held that an unreasonably small amount of liquidated damages constitutes a penalty and therefore does not bind the parties.[20] However,

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16. An argument could be made that section 2-719(1)(b) does not preclude damage remedies either. Section 2-719(1)(b) provides that resort to a contract remedy is optional unless the agreement expressly provides for the contrary. Assuming no such express language, if an injured party chooses not to seek the contract remedy, in this case liquidated damages, he should be able to seek *any* available alternative remedy, including actual damages, computed according to section 2-713, for example. Holding that he may not seek actual damages in effect would mean that the liquidated damages clause *is* exclusive.

17. Procter & Gamble Distrib. Co. v. Lawrence Am. Field Warehousing Corp., 16 N.Y.2d 344, 213 N.E.2d 873, 266 N.Y.S.2d 785 (1965); Silverman v. Alcoa Plaza Associates, 9 UCC Rep. Serv. 429 (N.Y. App. Div. 1971).

18. Knutton v. Cofield, 273 N.C. 355, 160 S.E.2d 29 (1968); Bradshaw v. Millikin, 173 N.C. 432, 92 S.E. 161 (1917); RESTATEMENT OF CONTRACTS § 339 (1932).

19. Knutton v. Cofield, 273 N.C. 355, 160 S.E.2d 29 (1968); City of Kinston v. Suddreth, 266 N.C. 618, 620, 146 S.E.2d 660, 662 (1966); UNIFORM COMMERCIAL CODE § 2-718(1). For discussions of factors influencing the determination of whether a contract term is a penalty see Knutton v. Cofield, *supra;* Bradshaw v. Millikin, 173 N.C. 432, 92 S.E. 161 (1917); Henderson v. Cansler, 65 N.C. 542 (1871); Lindsay v. Anesley, 28 N.C. 186 (1845).

20. Horn v. Poindexter, 176 N.C. 620, 622, 97 S.E. 653 (1918) ("[w]here the stipulated sum to be paid in a breach of the contract is of such a nature that the damages arising from a breach may be either much greater or much less than the sum fixed it will be construed to be a penalty."); BENDER'S UCC SERV., R. DUESENBERG & L. KING,

the North Carolina Supreme Court arguably disagreed with this theory in *City of Kinston v. Suddreth.*[21] There, plaintiff attacked the stipulated contract damages as a penalty in order to recover his actual damages that exceeded the penalty.[22] The court, however, refused to determine whether the stipulated sum in the contract was a penalty, noting that the result would be the same regardless of the classification. "If a provision denominated liquidated damages be deemed one for a penalty, 'the measure of damages is compensation for the actual loss, *not exceeding the penalty named.*' "[23] A close analysis of *Suddreth,* however, suggests that an earlier North Carolina case was more precise and reached a better result.[24]

Even when stipulated damages are not declared invalid as a penalty, a liquidated damages provision may still be declared invalid if damages from breach were easily ascertainable[25] at the time the contract was executed.[26] If a formula or some other method of calculating

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SALES AND BULK TRANSFERS, § 14.08, at 64 (1974). *See* UNIFORM COMMERCIAL CODE § 2-718, Comment 1.

21. 266 N.C. 618, 146 S.E.2d 660 (1966). *But see* Horn v. Poindexter, 176 N.C. 620, 622, 97 S.E. 653 (1918).

22. This same allegation could be made in a cotton contract case.

23. 266 N.C. at 621, 146 S.E.2d at 662, *quoting* Wheedon v. American Bonding & Trust Co., 128 N.C. 69, 71, 38 S.E. 255 (1901).

24. *See* note 20 *supra.* For three reasons the impact of *Suddreth* should be limited: (1) The strong reliance that the court placed upon Wheedon v. American Bonding & Trust Co., 128 N.C. 69, 38 S.E. 255 (1901), appears to be misplaced. *Wheedon,* which involved the liability of a surety on his bond, stated: "In an action on a *penal bond* for the perforcance [*sic*] of a contract, equity always interposes to relieve, and the measure of damages is compensation for actual loss, *not exceeding the penalty named.*" *Suddreth,* however, did not even acknowledge the possible distinctions between liquidated damages and bond liability.

(2) If *Suddreth* had been decided under the U.C.C., the same result would probably have been reached, *i.e.* the liquidated damages would have been awarded on the theory that they were "reasonable in the light of the . . . actual harm caused by the breach . . . ." UNIFORM COMMERCIAL CODE § 2-718(1). Therefore, the issue that the court avoided—whether the stipulated amount was liquidated damages or a penalty—would have been found to be valid liquidated damages.

(3) *Suddreth* ignored the possibility that an unreasonably small stipulated sum in a contract might constitute a penalty and thus might not bind the parties, as was recognized in Horn v. Poindexter, 176 N.C. 620, 97 S.E. 653 (1918). In fact it might be argued that *Suddreth* was concerned with the term "penalty" only in the context of unreasonably *high* stipulated damages. Thus, the holding in *Suddreth* might not apply to a "penalty" that is unreasonably *low.* Such a theory would reconcile *Suddreth* and *Wheedon* with the authorities cited in note 20 *supra.*

25. *See, e.g.,* Horn v. Poindexter, 176 N.C. 620, 97 S.E. 653 (1918); Winston-Salem Cigarette Mach. Co. v. Wells-Whitehead Tobacco Co., 141 N.C. 284, 53 S.E. 885 (1906); Thoroughgood v. Walker, 47 N.C. 16 (1854); UNIFORM COMMERCIAL CODE § 2-718(1); 22 AM. JUR. 2d *Damages* § 218 (1965); RESTATEMENT OF CONTRACTS § 339(1)(b) (1932).

26. The time of execution, not the time of the breach, is the proper time for determining whether damages were ascertainable. Robbins v. Plant, 174 Ark. 639, 297 S.W.

and ascertaining damages is available, the liquidated damages usually will be held invalid.[27] For example, some courts have held that, with a contract for the sale of goods having a readily available market price, damages for breach are ascertainable by applying the contract price-market price differential rule,[28] therefore invalidating the liquidated damages clause.[29]

As previously mentioned, a valid liquidated damages clause will not prevent the injured party from seeking the equitable remedy of specific performance absent express language in the contract to the contrary.[30] U.C.C. section 2-716(1) provides: "Specific performance may be decreed where the goods are unique or in other proper circumstances." While this language is vague, it is clear that the draftsmen desired to increase the availability of specific performance as a remedy.[31] If specific performance would have been available under prior law, it is available under the Code.[32] Under pre-Code law, specific performance was granted only in the "absence of an adequate and complete remedy at law."[33] Although courts have been particularly willing to grant specific performance of output contracts,[34] such as the cotton contracts in issue, such a grant has not been automatic.[35]

1027 (1927); Downtown Harvard Lunch Club v. Racso, Inc., 201 Misc. 1087, 107 N.Y.S.2d 918 (Sup. Ct. 1951); Knapp v. Ottinger, 206 Okla. 113, 240 P.2d 1083 (1951).

27. *See, e.g.*, Plymouth Sec. Co. v. Johnson. 335 S.W.2d 142 (Mo. 1960); City of St. Louis v. Parker-Washington Co., 271 Mo. 229, 196 S.W. 767 (1917); Horn v. Poindexter, 176 N.C. 620, 97 S.E. 653 (1918); Wilson v. Dealy, 222 Tenn. 196, 434 S.W.2d 835 (1968); Schwarz v. Lee, 287 S W. 519 (Tex. Civ. App. 1926).

28. UNIFORM COMMERCIAL CODE § 2-713.

29. Home Land & Cattle Co. v. McNamara, 145 F. 17 (7th Cir. 1906) (contract for the sale of cattle); Rice v. Schmid, 18 Cal. 2d 382, 115 P.2d 498 (1941); Stark v. Shemada, 187 Cal. 785, 204 P. 214 (1922) (contract for the sale of furniture); Marshall Milling Co. v. Rosenbluth, 231 Ill. App. 325 (1924); Nichols & Shepard Co. v. Beyer, 168 Mo. App. 686, 153 S.W. 794 (1913) (contract for the sale of threshing machines). *See* Sweet, *Liquidated Damages in California*, 60 CALIF. L. REV. 84 (1972). *But see* Calvin Hosmer, Stolte Co. v. Paramount Cone Co., 285 Mass. 278, 189 N.E. 192 (1934) (contract for the sale of flour).

30. UNIFORM COMMERCIAL CODE § 2-719(1)(b); *see, e.g.*, Tobacco Growers Cooperative Ass'n v. Pollock, 187 N.C. 409, 121 S.E. 763 (1924); Tobacco Growers Cooperative Ass'n v. Jones, 185 N.C. 265, 117 S.E. 174 (1923); Bradshaw v. Millikin, 173 N.C. 432, 436, 92 S.E. 161, 163 (1917). *See also* RESTATEMENT OF CONTRACTS § 378 (1932).

31. *See* UNIFORM COMMERCIAL CODE § 2-716, Comment 1; *id.* § 1-106(1).

32. *Id.* §§ 1-103, 2-716, Comment 1.

33. Annot., 152 A.L.R. 4, 47 (1944).

34. S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1419B (3d ed. 1968); Van Hecke, *Changing Emphases in Specific Performance*, 40 N.C.L. REV. 1, 4-8 (1961).

35. In determining the adequacy of the remedy in damages, as to contracts other than for the transfer of an interest in land, the following factors are influential and may singly or in combination justify specific enforcement: (a) the degree of difficulty and uncertainty in making an accurate valuation of the subject matter involved, in determining the effect of a breach, and in estimating

In North Carolina specific performance of contracts for the sale and delivery of personal property normally would not be granted, but it was granted when damages did not afford a complete remedy.[36] Several North Carolina cases in the 1920's, analogous to the present cotton contract cases, involved forward contracts, containing liquidated damages clauses, for the sale and delivery of tobacco.[37] The farmers later breached the contracts and attempted to sell their tobacco elsewhere. When the purchasers sued for specific performance, defendants contended that the liquidated damages clauses provided the exclusive remedy. However, the courts held that despite the liquidated damages clauses, plaintiffs were in effect entitled to specific performance in the form of an injunction forbidding the farmers from delivering the tobacco to anyone other than plaintiff.[38]

Since specific performance was available under pre-Code law, it should be granted under the U.C.C. in the present cases.[39] Further, recent authorities suggest that a party should be granted specific performance when the equities strongly favor him, regardless of whether such a remedy would have been appropriate under pre-Code law.[40] In

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> the plaintiff's harm; (b) the existence of sentimental associations and esthetic interests, not measurable in money, that would be affected by breach; (c) the difficulty, inconvenience, or impossibility of obtaining a duplicate or substantial equivalent of the promised performance by means of money awarded as damages; (d) the degree of probability that damages awarded cannot in fact be collected; (e) the probability that full compensation cannot be had without multiple litigation.

RESTATEMENT OF CONTRACTS § 361 (1932).

36. Virginia Trust Co. v. Webb, 206 N.C. 247, 173 S.E. 598 (1934); Tobacco Growers Cooperative Ass'n v. Battle, 187 N.C. 260, 121 S.E. 629 (1924).

37. The courts did not rely on a marketing act in reaching their decisions as did the court in *Arnette*, despite the fact that an agricultural cooperative was involved.

38. Tobacco Growers Cooperative Ass'n v. Pollock, 187 N.C. 409, 121 S.E. 763 (1924); Tobacco Growers Cooperative Ass'n v. Battle, 187 N.C. 260, 121 S.E. 629 (1924); Tobacco Growers Cooperative Ass'n v. Jones, 185 N.C. 265, 117 S.E. 174 (1923); *see* Campbell Soup Co. v. Diehm, 111 F. Supp. 211 (E.D. Pa. 1952) (injunction); Fraser v. Cohen, 159 Fla. 253, 31 So. 2d 463 (1947) (specific performance); Thompson v. Winterbottom, 154 Md. 581, 141 A. 343 (1928) (specific performance and injunction); Curtice Bros. Co. v. Catts, 72 N.J. Eq. 831, 66 A. 935 (Ch. 1907) (specific performance and injunction). *Contra*, Hearn v. Ruark, 148 Md. 354, 129 A. 366 (1925) (injunction denied, damages adequate). *See also* Van Hecke, *supra* note 34, at 4-5.

39. *See* text accompanying note 32 *supra*. In addition, the U.C.C. extends the availability of this equitable remedy to cases in which securing substitute goods is subjectively, highly difficult rather than objectively, virtually impossible. *See* UNIFORM COMMERCIAL CODE § 2-716, Comment 2; Peters, *Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two*, 73 YALE L.J. 199, 232-33 (1963).

40. Hale v. Higginbotham, 228 Ga. 823, 188 S.E.2d 515 (1972); Schweber v. Rallye Motors, Inc., 12 UCC REP. SERV. 1154 (N.Y. Sup. Ct. 1973); Comment, *Specific Performance Under Section 2-716 of the Uniform Commercial Code—What "Other Proper Circumstances"?*, 33 U. PITT. L. REV. 243 (1971).

the present cases the equities appear to favor the purchasers. First, the farmers are the breaching parties. Secondly, their sole reason for breaching was to enable them to obtain higher prices on the open market. Thirdly, in most cases the buyers, in reliance on the farmers' promises to deliver, entered second contracts with textile manufacturers for the sale and delivery of the cotton. The *Arnette* court further suggests that cotton contracts may be specifically enforced due to the "unusual interdependency of the various persons handling cotton from the time of its planting, through its sale, manufacture and delivery to the ultimate consumer."[41]

CONCLUSION

Arnette properly applied the U.C.C. and held the liquidated damages clause not to be an exclusive remedy. For those currently pending cotton contract cases involving similar factual situations in jurisdictions that have marketing acts similar to those in South Carolina and North Carolina, *Arnette* represents valid precedent for awarding specific performance. Whether specific performance will be available to non-agricultural-cooperative plaintiffs depends on interpretation of the U.C.C. and pre-Code case law. Fortunately for such plaintiffs the U.C.C. favors the granting of specific performance.[42] Indeed, the simple, equitable solution to these cases would be to grant such relief in the absence of a contract term permitting the farmer an election to perform or to pay liquidated damages.[43] This solution is based primarily on the axiom that a man should be required to perform any arms-length agreement that he enters, even when it later proves to be a bad bargain.

DANIEL BLUE DEAN

41. 371 F. Supp. at 70.
42. *See* text accompanying notes 30-32 *supra*.
43. Bell v. Smith Concrete Prods., Inc., 263 N.C. 389, 139 S.E.2d 629 (1965).