

BARRIE SCHOOL v. PATCH
Maryland Court of Appeals
401 Md. 497, 933 A.2d 382 (2007)

BELL, C.J., RAKER, WILNER, CATHELL, HARRELL, BATTAGLIA, GREENE, JJ. Opinion by RAKER, J. BELL, C.J., Dissents.

Opinion by Raker, J.

The primary question we must decide in this case is whether a non-breaching party to a contract has a duty to mitigate damages where the contract between the parties contains a valid liquidated damages clause. We shall answer that question in the negative and hold that a non-breaching party has no duty to mitigate damages where the parties agree to a valid liquidated sum in the event of a breach.

I.

Petitioner, The Barrie School, is a private, non-profit Montessori school located in Silver Spring, Maryland. Respondents, Andrew and Pamela Patch, are parents who enrolled their daughter, Christiana, in The Barrie School for the 2004-2005 academic year. The Patch's entered into a re-enrollment agreement (the "Agreement") with The Barrie School that contained a specific deadline for cancelling the Agreement. The Agreement stated that if respondents withdrew their child from The Barrie School after a specific date, respondents would pay tuition for the entire academic year as liquidated damages.

The Agreement provided for a \$ 1,000.00 non-refundable deposit and payment of the remaining tuition balance of \$ 13,490.00 in two installments. The Agreement contained an escape clause that allowed for unilateral cancellation, provided that the head of the school received written notice by certified letter before May 31, 2004. Under § 3 of the Agreement, respondents were obligated to pay the full tuition if they failed to meet the May 31, 2004 deadline for withdrawal. Section 3 of the Agreement provided as follows:

"I understand that unless the Student is withdrawn by written notice given by certified letter, return receipt requested, and received by the Head of School prior to May 31, 2004, I am liable for and agree to pay the entire year's charges for the academic year, including expenses, as later defined, incurred by the School for collection. Withdrawal, dismissal, absences or illness of Student during the year do not release me from any portion of this obligation."

The Patch's did not cancel the Agreement on or before May 31, 2004.

On July 14, 2004, forty-four days after the withdrawal deadline noted in § 3 of the Agreement, the Patch's sent a cancellation notice via facsimile to The Barrie School's admissions office and demanded a refund of their initial deposit. Respondents refused to pay any of the remaining tuition balance to the school and enrolled Christiana in another school.

The Barrie School filed a breach of contract action against respondents in the District Court of Maryland, sitting in Montgomery County. The Barrie School sought the remaining tuition balance for the 2004-2005 academic year, plus 12% interest, and attorney's fees. In their notice of intent to defend, respondents claimed that the Agreement had been procured by fraud, that it was a contract of adhesion, that the damages constituted a penalty, that The Barrie School had a duty to mitigate any damages, and that the Agreement was unenforceable because it violated public policy and Maryland's anti-competition laws.¹ Respondents also filed a counter-claim, seeking the return of their \$ 1,000.00 deposit, interest, and attorney's fees.

The case proceeded to trial before the District Court. Charles Shayler, the Chief Financial Officer of The Barrie School, testified for petitioner; Andrew and Pamela Patch testified on their own behalf. Respondents' major argument at the close of evidence was that The Barrie School had a duty to mitigate its damages, notwithstanding the language of § 3 of the Agreement.

The District Court found that there was a valid contract between the parties, including a valid liquidated damages clause, that there was no fraud in the inducement to enter into the Agreement, and that the Agreement was not a contract of adhesion. Accordingly, the court denied respondents' counterclaim. With respect to the liquidated damages clause, the court reasoned as follows:

"I am satisfied that it is a valid liquidated damages provision, that based on the testimony of Mr. Goss, that there was--it would have been next to impossible to assign an exact amount as to the impact of losing one child for the school year. And that in light of that, and the fact that A, it was agreed to by the parties, this was not a contract of adhesion, certainly as I understand a contract of adhesion to be. These people could simply have walked away from this. Their lives did not--did not depend on signing this contract. And that basing one year's tuition or using one year's tuition as the measure is certainly not unreasonable and in fact, Mr. Goss' testimony was that it--probably the one year's tuition probably represented less than the actual costs of educating the child at Barrie School. Okay, so I find the contract is okay, including the liquidated damages provision."

The court next addressed respondents' argument that, notwithstanding a valid liquidated damages clause, a non-breaching party has a duty to mitigate damages. The court concluded that The Barrie School's failure to mitigate damages was fatal to its claim, reasoning as follows:

"There is obviously the issue that I was most concerned with, and that was the issue of what effect liquidated damages has on the general rule that a party in--Plaintiff in the face of a breach does have some duty to mitigate.

¹ Based on the record from the District Court proceedings, it appears that respondents abandoned this final claim.

Even if the amount is difficult to determine, I don't see why in the world they still shouldn't do something to mitigate. And again, even if the tuition amount does not exactly hit the number, it sure comes close to it in terms of going toward making them whole.

And it's unquestionable that they did absolutely nothing whatsoever to try to fill the space for this child once they got the word in July that she was--that she was not going to be there. They--they didn't go through their old applications, they didn't put out any advertisements. They did absolutely nothing. And I understand there is the black letter rule. But I think even black letter rules are subject to some exception, and I don't see why, under the circumstances of this case, when they--even if it couldn't exactly correspond to exact amount that they would have been harmed, they--again, could have done a lot to have helped themselves out, at least to the extent of the amount they're suing for in this case. And that their failure to do so I do find to be fatal.

So for that reason I'm going to also grant a Defendants' verdict on The Barrie School as Plaintiff."

The court entered judgment in favor of respondents on The Barrie School claim.

The Barrie School noted a timely appeal to the Circuit Court for Montgomery County....

In a written opinion, the Circuit Court agreed with the District Court and held that even though the liquidated damages clause was valid and not a penalty, The Barrie School had a duty to mitigate damages. The court affirmed also the District Court holding that there was no fraud on The Barrie School's part and found that the District Court did not err in denying portions of respondents' discovery request. The Circuit Court stated as follows:

"The question is presented as to whether a party who is protected by a liquidated damages clause in a contract is excused of the normal contractual duty to mitigate its damages as a prerequisite to recovery. The court finds that such a duty does exist, notwithstanding the existence of a liquidated damages clause, and, thus, the District Court did not err as a matter of law in so finding. It is interesting to note that while no evidence of mitigation was presented, it would appear that mitigation had, in effect, already occurred when The Barrie School already enrolled more students than its budget projections called for."

We granted The Barrie School's petition for a writ of certiorari to this Court

II.

Before this Court, The Barrie School argues that a non-breaching party has no duty to mitigate damages where the parties have agreed to a valid liquidated sum in the event of breach. The school states that it is well settled that liquidated damages clauses are recognized and enforced

in Maryland and that, when valid, such clauses do not require the injured party to reduce the agreed-upon amount by avoiding loss....

Respondents do not appear to controvert petitioner's argument that there exists a liquidated damages clause in the Agreement. Rather, respondents argue that the general law of contracts, *i.e.*, the general duty to mitigate damages in the event of a breach, applies to a contract containing a liquidated damages provision. Respondents argue that the purpose of a liquidated damages clause is "solely to agree on the *amount* of damages," stating that "it does not have and should not have any effect on whether avoidable damages should be mitigated." In addition to their mitigation argument, respondents contend that The Barrie School suffered no actual damages from the breach because it enrolled more students than originally expected in the 2004-2005 enrollment projections. ...

III.

Liquidated damages have been defined as a specific sum stipulated to and agreed upon by the parties at the time they entered into a contract, to be paid to compensate for injuries in the event of a breach of that contract. *Board of Education v. Heister*, 392 Md. 140, 155, 896 A.2d 342, 351 (2006) (stating that a liquidated damages clause is "a specific sum of money . . . expressly stipulated by the parties to a . . . contract as the amount of damages to be recovered by either party for a breach of the agreement by the other"). Whether a contract provision is a penalty or a valid liquidated damages clause is a question of law, reviewed *de novo* by this Court. *Id.* See also *Hammaker v. Schleigh*, 157 Md. 652, 667, 147 A. 790, 796 (1929).

Because respondents seek to set aside the bargained for contractual provision in the Agreement stipulating damages in the event of breach, respondents have the burden of proving that the clause should not be enforced. Placing the burden of proof on the challenger is consistent with giving the non-breaching party the advantage inherent in stipulated damages clauses, that of eliminating the need to prove damages, and with the general principle of Maryland law that assumes that bargains are enforceable and that the party asking the court to invalidate a bargain should demonstrate the justice of his or her view. See *Dashiell v. Meeks*, 396 Md. 149, 167, 913 A.2d 10, 20 (2006).

It has long been the rule in Maryland that valid liquidated damages provisions are enforceable. Our predecessors stated "the settled rule of law" with respect to liquidated damages as follows:

"[W]here the parties, at or before the time of the execution of the contract, agree upon and name a sum therein to be paid as liquidated damages, in lieu of anticipated damages which are in their nature uncertain and incapable of exact ascertainment, that the amount so named in the agreement will be regarded as liquidated damages and not as a penalty, unless the amount so agreed upon and inserted in the agreement be grossly excessive and out of all proportion to the damages that might reasonably have been expected to result from such breach of the contract. And whether it is excessive or whether the damages are incapable of exact ascertainment should be determined from the subject-matter of the contract considered in the light of all the surrounding facts and circumstances connected therewith and known to

the parties at the time of its execution. That these questions should be considered and determined from the contract itself, its subject-matter and the surrounding facts and circumstances connected therewith with which the parties are confronted at the time of its execution, is made necessary in order to ascertain the intention of the parties, which is one of the essential factors in deciding whether the stipulation is for liquidated damages or is a penalty. It may afterwards be disclosed that the damages actually sustained are more or less than those anticipated at the time of the execution of the contract. If more, this fact would not characterize or stamp the stipulation as a penalty unless it was so exorbitant as to clearly show that such amount was not arrived at in a *bona fide* effort, made at or before the execution of the contract, to estimate the damages that might have been reasonably expected to result from a breach of it, and that it was named as a penalty for such breach. And on the other hand, if the amount stipulated was found to be inadequate, a greater amount could not be recovered for such breach, because of the agreement between the parties that the amount so named should be in lieu of the damages resulting therefrom." *Balto. Bridge Co. v. U. Rwy. & E. Co.*, 125 Md. 208, 214-15, 93 A. 420, 422-23 (1915). This Court has not strayed from the notion that, absent specific statutory provisions, the time of contract formation is the appropriate point from which to judge the reasonableness of a liquidated damages provision.

Writing for this Court, Judge Harrell elucidated more recently the elements of a liquidated damages provision, stating as follows:

"There are three essential elements of a valid and enforceable liquidated damages clause. First, such a clause must provide in clear and unambiguous terms for a certain sum. Secondly, the liquidated damages must reasonably be compensation for the damages anticipated by the breach. Thirdly, liquidated damage clauses are by their nature mandatory binding agreements before the fact which may not be altered to correspond to actual damages determined after the fact. While the language used by the parties is instructive in determining the validity of a liquidated damages clause, the decisive element is the intention of the parties--whether they intended that the sum be a penalty or an agreed-upon amount as damages in case of a breach and this is to be gleaned from the subject matter, the language of the contract and the circumstances surrounding its execution." *Heister*, 392 Md. at 156, 896 A.2d at 352 (internal citations and quotations omitted).

Despite their general propriety, a clause purporting to provide liquidated damages will be deemed invalid as a penalty where the amount agreed upon is "grossly excessive and out of all proportion to the damages that might reasonably have been expected to result from such breach of the contract." *Balto. Bridge Co.*, 125 Md. at 215, 93 A. at 422. As Professor Williston has noted, "a liquidated damages provision will be held to violate public policy, and hence will not be enforced, when it is intended to punish, or has the effect of punishing, a party for breaching the contract, or when there is a large disparity between the amount payable under the provision and the actual damages likely to be caused by a breach, so that it in effect seeks to coerce performance of the underlying agreement by penalizing nonperformance and making a breach prohibitively and

unreasonably costly." 24 RICHARD A. LORD, WILLISTON ON CONTRACTS § 65:1, at 216-23 (4th ed. 2002) (internal citations and footnotes omitted).

We have long recognized that "one of the most difficult and perplexing inquiries encountered in the construction of written agreements" is determining whether a contractual clause should be regarded as a valid and enforceable liquidated damages provision or as a penalty. *Willson v. M. & C. C. of Baltimore*, 83 Md. 203, 211, 34 A. 774, 775 (1896). Thus, "if there is doubt whether a contract provides for liquidated damages or a penalty, the provision will be construed as a penalty." *Goldman v. Conn. Gen. Life Ins. Co.*, 251 Md. 575, 581, 248 A.2d 154, 158 (1968).

Maryland courts will uphold a liquidated damages clause as valid, and not a penalty, if it satisfies two primary requirements. First, the clause must provide a fair estimate of potential damages at the time the parties entered into the contract. *See Heister*, 392 Md. at 157, 896 A.2d at 352; *Goldman*, 251 Md. at 582, 248 A.2d at 158; *H. J. McGrath Co. v. Wisner*, 189 Md. 260, 265, 55 A.2d 793, 795 (1947); *Hammaker*, 157 Md. at 667, 147 A. at 796; *Balto. Bridge Co.*, 125 Md. at 214, 93 A. at 422. Second, the damages must have been incapable of estimation, or very difficult to estimate, at the time of contracting. *See Heister*, 392 Md. at 157, 896 A.2d at 352; *Goldman*, 251 Md. at 582, 248 A.2d at 158; *Wisner*, 189 Md. at 265, 55 A.2d at 795; *Hammaker*, 157 Md. at 667, 147 A. at 796; *Balto. Bridge Co.*, 125 Md. at 214, 93 A. at 422.

As we have indicated, in the absence of a statute providing otherwise, Maryland courts determine the validity of a liquidated damages clause by looking to the stipulated loss at the time of the contract's formation, and not actual losses resulting from breach.⁵ *See Heister*, 392 Md. at 158, 896 A.2d at 353 (stating that "whether the amount specified is a penalty or liquidated damages is to be determined as of the time of execution of the contract" (quoting *Anne Arundel Co. v. Norair Engineering Corp.*, 275 Md. 480, 494, 341 A.2d 287, 294 (1975))); *Hammaker*, 157 Md. at 667, 147 A. at 796 (stating that in order for a "declared forfeit to become liquidated damages by interpretation, it must clearly appear that the amount named was reasonable compensation in fact at the time when the contract was made").

⁵ For statutory provisions providing otherwise, see, for example, the Uniform Commercial Code § 2-718(1) and the corresponding Maryland provision applying to the sale of goods, Md. Code (1975, 2002 Repl. Vol.), § 2-718(1) of the Commercial Law Article (stating that damages "may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach"), Md. Code (1975, 2005 Repl. Vol.), § 14-1106(c) of the Commercial Law Article (noting that under Maryland's laws governing layaway sales, the seller may "retain as liquidated damages an amount not to exceed 10 percent of the layaway price or the total amount paid by the buyer to the date of default, whichever is less"), Md. Code (1975, 2005 Repl. Vol.), § 22-804(a) of the Commercial Law Article (noting that under the Maryland Uniform Computer Information Act, damages for breach of contract may be liquidated by either party in an amount that is reasonable in light of anticipated loss, actual loss, or actual or anticipated difficulties of proving loss in the event of breach), and Md. Code (1973, 2006 Repl. Vol.), § 10-410(a)(1) of the Courts and Judicial Proceedings Article (noting that any person whose wire, oral, or electronic communications are used in violation of that subtitle is entitled to "[a]ctual damages but not less than liquidated damages computed at the rate of \$ 100 a day for each day of violation or \$ 1,000, whichever is higher").

In the case *sub judice*, the lower courts found correctly that § 3 of the Agreement was a valid liquidated damages clause and not a penalty. The sum in § 3 was a reasonable forecast of just compensation for potential harm caused by a breach of the Agreement. The damages contemplated in the Agreement were neither grossly excessive nor out of all proportion to those which might have been expected at the time of contracting.⁶ See *Lake Ridge Academy v. Carney*, 66 Ohio St. 3d 376, 613 N.E.2d 183 (Ohio 1993) (finding that a year's tuition constitutes a reasonable liquidated sum for breach of a school enrollment contract); *Wentworth Military Academy v. Marshall*, 225 Ark. 591, 283 S.W.2d 868 (Ark. 1955) (same); *Kentucky Military Institute v. Bramblet*, 158 Ky. 205, 164 S.W. 808 (Ky. 1914) (same); *Teeter v. Horner Military School*, 165 N.C. 564, 81 S.E. 767 (N.C. 1914) (same).

The actual damages resulting from breach would have been very difficult to estimate at the time of contracting as well. The Barrie School's Chief Financial Officer testified to this effect before the District Court, stating as follows:

"The budget's developed in November and December of the preceding year, and reviewed and approved in January of the preceding year. We determine the total number of expenses, faculty and otherwise, to instruct our students, and we then, because we're a non-profit and we try to have a balanced budget, we then determine what tuition level needs to be set, and the number of students to meet the revenue goal. So to parse out of that the effect of one student is very difficult."

As the Circuit Court noted, "it would be next to impossible to assign an exact amount as to the impact of losing one child for the school year." Section 3 of the Agreement constitutes a valid liquidated damages clause.

Respondents argue that there exists a duty to mitigate damages even in the face of a valid liquidated damages clause. Respondents would have us hold that there is such a duty because parties to a contract are required usually to minimize loss in the event of breach. In *Circuit City v. Rockville Pike*, 376 Md. 331, 829 A.2d 976 (2003), we addressed the concept of mitigation of damages, stating as follows:

"We have recognized generally that, when one party breaches a contract, the other party is required by the 'avoidable consequences' rule of damages to make all reasonable efforts to minimize the loss sustained from the breach and can charge the defending party only with such damages as, 'with reasonable endeavors and expense and without risk of additional substantial loss or injury, he could not prevent.'"

Id. at 355, 829 A.2d at 990 (quoting *Sergeant Co. v. Pickett*, 285 Md. 186, 203, 401 A.2d 651, 660 (1979)). As we made clear in *Circuit City*, mitigation of damages helps to determine the proper

⁶ We do not address the enforceability of specific contractual provisions related to liability for school tuition and related charges in the event of nonattendance under circumstances related to serious illness, military transfers, and the like.

amount of damages resulting from a breach of contract. In other words, it is part of the law of court-assessed damages.

Liquidated damages differ fundamentally from mitigation of damages. While mitigation is part of a court's determination of actual damages that have resulted from a breach of contract, liquidated damages clauses are the remedy the parties to a contract have determined to be proper in the event of breach. Where the parties to a contract have included a reasonable sum that stipulates damages in the event of breach, that sum replaces any determination of actual loss. Professor Williston has explained this principle as follows:

"[O]ne purpose of a liquidated damages provision is to obviate the need for the nonbreaching party to prove actual damages. Thus, where the liquidated damages clause represents a reasonable attempt by the parties to agree in advance upon a sum that will compensate the nonbreacher for any harm caused by the breach, in lieu of the compensatory contract damage to which the nonbreacher would otherwise be entitled, the clause will be upheld."

LORD, *supra* § 65:1, at 230 (internal citations and quotations omitted). *See also* 11 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 1062, at 307 (interim ed. 2002) (stating that a valid liquidation of damages makes other proof as to the amount of injury unnecessary). It follows naturally that once a court has determined that a liquidated damages clause is valid, it need not make further inquiries as to actual damages. This includes a determination of whether the parties attempted to mitigate damages resulting from breach.

Judge Richard Posner of the United States Court of Appeals for the Seventh Circuit noted the distinction between liquidated damages and the duty to mitigate in *Lake River Corp. v. Carborundum Co.*, 769 F.2d 1284 (7th Cir. 1985). That case involved a shipping contract in which one party to the contract failed to fulfill the terms of the agreement after market prices shifted. Although the court found that the contractual clause at issue was invalid as a penalty, the court nonetheless explained the distinction between mitigation of damages and liquidated damages, stating as follows:

"[M]itigation of damages is a doctrine of the law of court-assessed damages, while the point of a liquidated-damages clause is to substitute party assessment; and that point is blunted, and the certainty that liquidated-damages clauses are designed to give the process of assessing damages impaired, if a defendant can force the plaintiff to take less than the damages specified in the clause, on the ground that the plaintiff could have avoided some of them."

Lake River Corp., 769 F.2d at 1291.

As Judge Posner noted in *Lake River Corp.*, the purpose of § 3 of the Agreement would be "blunted" if The Barrie School were required to mitigate damages. The parties to the Agreement determined that a certain sum would be paid in order to avoid the necessity of determining actual damages that might have resulted from breach. As a necessary conclusion, § 3 of the Agreement was a comprehensive sum that eliminated the need to calculate actual losses, including any

mitigation of damages that might have occurred. Maryland's approach to liquidated damages supports this conclusion, as we view such clauses as "binding agreements *before the fact* which may not be altered to correspond to actual damages determined after the fact." *Heister*, 392 Md. at 156, 896 A.2d at 352 (emphasis added) (internal citations and quotations omitted). Because mitigation of damages is part of a post-breach calculation of actual damages, in the absence of a statute mandating mitigation of damages, there exists no duty to mitigate damages where a valid liquidated damages clause exists.

Section 3 of the Agreement is a valid liquidated damages clause and not a penalty. Therefore, The Barrie School had no duty to mitigate damages and was entitled to the sum enumerated in § 3 of the Agreement.

Finally, in addition to arguing the duty to mitigate, respondents claim the defense of no-actual-harm. Respondents contend that because The Barrie School filled their daughter's space and actually enrolled more students than anticipated originally, the school suffered no harm from its breach of the Agreement. We reject this defense in this context. The same rationale we rely on in rejecting the duty to mitigate in the face of a valid liquidated damages provision applies to the no-actual-harm defense. Such a defense negates the benefit of an agreed-upon or stipulated damages clause and deviates from our acceptance of the principle that the time of contract formation is the appropriate point from which to judge the reasonableness of a stipulated amount of damages. It would also breed uncertainty in the calculation of damages, because if we were to accept the no-actual-harm defense, why would courts not then give greater damages than contemplated when the damages actually exceeded the stipulated amount? ...

IV.

We address respondents' remaining contentions. Respondents argue that the Agreement was a contract of adhesion because it specified, in bold, capital letters that "**ANY ALTERATIONS OR MODIFICATIONS TO THIS AGREEMENT WILL NOT BE ACCEPTED BY THE SCHOOL.**" Respondents reason that because there was a gross inequity of bargaining power and The Barrie School imposed a liquidated damages provision in the Agreement, the provision was unenforceable. Both lower courts found that the Agreement was not a contract of adhesion. We agree with the lower courts.

We note that a contract of adhesion is not void per se. *Walther v. Sovereign Bank*, 386 Md. 412, 430, 872 A.2d 735, 746 (2005). A court will find a contract of adhesion unenforceable only if it is unconscionable. *Id.* In the instant case, the Agreement was neither a contract of adhesion nor unconscionable. An unconscionable contract involves extreme unfairness, "made evident by (1) one party's lack of meaningful choice, and (2) contractual terms that unreasonably favor the other party." *Id.* at 426, 872 A.2d at 743 (internal citations and quotations omitted). Respondents were not forced to enroll their child at The Barrie School. Moreover, the "escape clause" was put into the Agreement for the benefit of respondents. If respondents did not want to enroll their child at the school, all they needed to do was to notify school officials before May 31, 2004, and they would have incurred no financial liability. But for that provision respondents would have been bound to the Agreement without any opportunity for a refund. Respondents have not established that they had no choice but to enroll their child at The Barrie School, and the record does not

suggest that the Agreement was anything but an arm's-length business transaction. Therefore, we conclude that the District Court did not err in concluding that the Agreement was not a contract of adhesion. ...

JUDGMENT OF THE CIRCUIT COURT FOR MONTGOMERY COUNTY REVERSED.
CASE REMANDED TO THAT COURT WITH INSTRUCTIONS TO REMAND THE CASE
TO THE DISTRICT COURT TO RENDER JUDGMENT CONSISTENT WITH THIS
OPINION.

Dissenting Opinion by BELL, C.J.

The Majority, agreeing that the liquidated damages clause embodied in § 3 of the re-enrollment agreement ("the Agreement") between the appellant, The Barrie School ("the School"), and the appellees, Mr. and Mrs. Patch ("the Patches"), and on which the trial courts relied, is valid, reverses the judgment of the Circuit Court for Montgomery County because it concludes that where the liquidated damages clause is valid, there is no duty to mitigate. *Barrie School v. Patch*, 401 Md. 497, 512-13, 933 A.2d 382, 391-92 (2007). I disagree. I am troubled by the result reached by the Majority, as it undermines basic principles of contract law pertaining to the equity and reasonableness of contract remedies.

It is a long-held, and well-settled, general principle of contract law that contract remedies are to be compensatory, not punitive. Restatement (Second) of Contracts § 356, comment a (1981)(stating that "the central objective behind the system of contract remedies is compensatory, not punitive). ...

Integral to the inquiry into the validity of a liquidated damages clause is determining whether the clause is fair and reasonable. The vantage point from which that determination is made is critical to, and may be dispositive of, that inquiry. The Majority maintains that "the time of the contract formation is the appropriate point from which to judge the reasonableness of a liquidated damages provision." 401 Md. 497, 509, 933 A.2d 382, 389. Focusing exclusively on this "prospective view" leads the Majority to the conclusion it reaches.

There is another "view," however. Because the validity of a liquidated damages does not become an issue until one of the parties breaches the contract to which it relates, it follows, logically, that the review of a liquidated damages clause to determine whether it is a penalty should include the effect of the breach, at the least, whether actual damage have been incurred. ...

[According to the] second Restatement:

"[T]wo factors combine in determining whether an amount of money fixed as damages is so unreasonably large as to be a penalty. The first factor is the anticipated or actual loss caused by the breach The second factor is the difficulty of proof of loss If the difficulty of proof of loss is great, considerable latitude is allowed in that approximation of anticipated or actual harm. If, on the other hand, the difficulty of proof of loss is slight, less latitude is allowed in that

approximation. 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."

§ 356 at comment b (emphasis added). See *Mattingly Bridge Co. v. Holloway & Son Const. Co.*, 694 S.W.2d 702, 705 (Ky. 1985), in which the Supreme Court of Kentucky, adopting Restatement (Second) Contracts § 356(1) (1981) "as a reasonable expression of the rule applicable to liquidated damages" acknowledged that liquidated damages clauses are "useful commercial tool[s] to avoid litigation to determine actual damages," subject, however, to two restrictions: "they should be used only (1) where the actual damages sustained from a breach of contract would be very difficult to ascertain and (2) where, after the breach occurs, it appears that the amount fixed as liquidated damages is not grossly disproportionate to the damages actually sustained." (emphasis added)....

The viability of a liquidated damages clause, thus, does not depend solely on the fixed amount for which the parties contracted; rather, all of the surrounding circumstances are important, those existing at the time of contracting, as well as those existing at the time of the breach, and they include consideration of the actual damages sustained. See *Baybank Middlesex v. 1200 Beacon Props., Inc.*, 760 F. Supp. 957, 964 (D. Mass. 1991) ("In order to determine whether the liquidated damages provision is valid, this Court must examine the reasonableness of the liquidated damages provision, both retrospectively, and at the time the parties agreed to it.") (emphasis added); *Independent Sch. Dist. v. Dudley*, 195 Iowa 398, 192 N. W. 261, 263 (Iowa 1923) ("[T]he tendency of the courts in recent years has been to look into all the circumstances and give effect to such an agreement only so far as equity and good conscience will permit, and if the sum stipulated is out of reasonable proportion to the loss or injury actually sustained . . . it will be treated as a penalty only."); *Lake Ridge Academy v. Carney*, 66 Ohio St. 3d 376, 613 N.E.2d 183, 188 (Ohio 1993)("[W]hen a stipulated damages provision is challenged, the court must step back and examine it in light of what the parties knew at the time the contract was formed and in light of an estimate of the actual damages caused by the breach.") (emphasis added). This is, in my view, the only way in which to be completely fair to both parties.

In the case sub judice, there is no doubt that the Patches breached their Agreement with the School. On the other hand, the record indicates that the School did not suffer harm commensurate to the sum fixed as liquidated damages. While the Patches' daughter did not attend the School, it is undisputed that the School met its enrollment projections for that year; there was "no empty desk" for which budgetary projections were made, yet not realized. Looking at the provision retrospectively, it is clear that the School should not be awarded a full year's tuition, as this amount is grossly disproportionate to, and in excess of, the harm it actually suffered. ...

The Majority rejects "no-actual-harm" as a defense. It argues that "[s]uch a defense negates the benefit of an agreed-upon or stipulated damages clause[.]" 401 Md. 497, 515, 933 A.2d 382, 393. The Majority also believes that "[i]t would also breed uncertainty in the calculation of damages, because if we were to accept the no-actual-harm defense, why would courts not then give greater damages than contemplated when the damages actually exceeded the stipulated amount?" *Id.* This view is not supported by the precedent on which the Majority itself relies. In *Baltimore Bridge*, this Court opined:

"It may afterwards be disclosed that the damages actually sustained are more or less than those anticipated at the time of the execution of the contract. If less, this fact would not characterize or stamp the stipulation as a penalty unless it was so exorbitant as to clearly show that such amount was not arrived at in a bona fide effort, made at or before the execution of the contract, to estimate the damages that might have been reasonably expected to result from a breach of it, and that it was named as a penalty for such breach. And, on the other hand, if the amount stipulated was found to be inadequate, a greater amount could not be recovered for such breach, because of the agreement between the parties that the amount so named should be in lieu of the damages resulting therefrom."

125 Md. at 215, 93 A. at 422-23. This is consistent with my position and with principles of fairness and equity; liquidated damages clauses limit recovery where the actual damages suffered are greater, while yet allowing exorbitant, excessive sums to be challenged. This is not at all contrary to the purpose of such clauses.

To be sure, the School is entitled to compensation for any and all damages it suffered as a result of the contract breach. When, however, considered retrospectively, it is determined that the School's recovery will be excessive, the liquidated damages clause that provides for that recovery is invalid and unenforceable. That simply means that the School will have to prove its actual damages as it would in any breach of contract action and will be required, moreover, to mitigate its damages, if the circumstances make that appropriate.

The purpose of imposing a duty to mitigate damages is to "encourag[e] the injured party to attempt to avoid loss." Restatement (Second) of Contracts § 350 at comment a. This Court has held, in accordance with this general "avoidable consequences" rule of damages, that "the ordinary rule with respect to minimization of damages . . . [is] that 'damages are not recoverable if the consequences of a breach are avoidable. In other words, a plaintiff is not entitled to a judgment for damages for a loss that he could have avoided by a reasonable effort without risk of additional loss or injury.'" *Sergeant Co. v. Pickett*, 285 Md. 186, 191- 92, 401 A.2d. 651, 654 (1979), quoting *M & R Contractors & Builders v. Michael*, 215 Md. 340, 354-55, 138 A.2d 350, 358 (1958); *Circuit City Stores, Inc. v. Rockville Pike Joint Venture Ltd. Partnership*, 376 Md. 331, 355-56, 839 A.2d 976, 990 (2002).

... The liquidation of damages and the mitigation of damages are, indeed, distinct and separate concepts, which must be treated as such, i.e., there is no exception to the general contractual duty to mitigate simply because a fixed sum has been agreed upon by the parties in advance. That is to say, whether mitigation of damages applies, or not, should be determined when, post-breach, a court considers whether there have been actual damages incurred at all. ...

To uphold the liquidated damages clause in the case *sub judice* would be unfair to the Patches. General contract principles make that clear. I would affirm the judgment of the Circuit Court.

For the foregoing reasons, I dissent.