

Incentive-ize Don't Penalize; Liquidated Damages under New York Law

By: Kaiser Wahab

By including a liquidated damages clause when negotiating a contract, parties can estimate the amount of damages to serve as a remedy in the event of a breach. This can be a helpful legal tool that limits litigation over the issue. Furthermore, liquidated damage clauses are often designed to address very specific types of breaches or establish a gradient of damages based on the degree of a breach. However, drafting and enforcing liquidated damage clauses can become tricky when it comes to New York.

Contrary to what the “liquidated damages” name suggests, it provides a reasonable pre-determined damages award, adding greater insurance, predictability, clarity, and above all deterrence value to a contract. Such clauses can guard against delay in performance, outright failure to perform, and a variety of other breach scenarios. Moreover, the value of the damages clause does not have to be an accurate portrait of what “actual” damages would be upon breach. They need to be a reasonable approximation of harm suffered, they need to be specific and/or set out a specific formula, and they should not seek to penalize the breaching party. [Read more on liquidated damages clauses here.](#)

The Uniform Commercial Code

The Uniform Commercial Code, a legal framework created to unify sales and commercial transactions law for all 50 states, provides that parties may choose between remedies if multiple remedies are described in the contract. The parties also do not need to use definitive language to ensure this right and all other contractual remedies such as liquidated damages are considered optional, unless the contract lists a remedy as exclusive.

Moreover, the UCC supports liquidated damages clauses and provides guidelines as to how to draft them. It suggests that the parties should consider a) the anticipated or actual harm caused by the breach; b) the degree of difficulty in proving loss; and c) the burden of employing other remedies, when formulating the clauses.

New York at Odds with UCC

Although the UCC may appear to simplify the formation and enforcement of liquidated damages clauses, its rules governing the subject are at odds with those of New York State. As a result, parties to a New York contract may face a situation where every word of a sales contract has to be carefully construed so as not to risk waiving a party's right to certain remedies.

In New York, liquidated damages can be applied as a remedy for breach of contract if: a) the parties had the intention to liquidate damages rather than to provide for a penalty; b) if the liquidated damages clause requests an amount that corresponds to a reasonable relationship to the anticipated loss incurred by the non-breaching party; and c) if the actual loss is hard or impossible to identify or estimate.

In NY, Elect not to Elect

More importantly, liquidated clauses are not enforceable if they contain a right of election. According to NY courts, such election rights represent an intent to penalize the breaching party, eradicating the parties' intention to liquidate damages in the event of breach. NY courts have also held that since neither party intends the specified amount to be the final accounting of damages, the provision would not constitute a valid liquidated damages clause. When a liquidated damages clause is unenforceable, the non-breaching party is restricted to standard, actual legal or equitable remedies for breach of contract.

Liquidated Damages Best Practices in NY

Nevertheless, parties to a contract in New York can take several steps to increase the enforceability of their liquidated damages clauses. Some of these steps entail avoiding right of election language as an alternative remedy and clearly specifying the amount of liquidated damages, provided it is reasonable and not attempting to penalize the other party. Language designed to allow a party to select alternative remedies, either in addition to or instead of liquidated damages, is currently unenforceable under New York law. Therefore, liquidated damages must be expressly stated as the exclusive remedy for the breach.

Conclusion

In conclusion, the enforceability of a contract's liquidated damages clause relies on accurate phrasing to satisfy New York law and forgoing an election of remedies for breach. To achieve this, the parties should include an express statement that the liquidated damages are the sole remedy for a breach and avoid using words that allow for the selection of alternative remedies.

ATTORNEY ADVERTISING. Results depend on a number of factors unique to each matter. Prior results do not guarantee a similar outcome.