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CONTRACTS-LAW APPLYING TO GOVERNMENT CONTRACTS-PENALTY CLAUSES

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CONTRACTS—LAW APPLYING TO GOVERNMENT CONTRACTS—PENALTY CLAUSES—Petitioner contracted with the Federal Surplus Commodities Corporation of the United States Department of Agriculture to supply dried eggs under the Lend-Lease Act of 1941.[1] Delivery was to be made on the "first day of a 10-day period within which the F. S. C. C. will accept delivery." The ten-day period started on May 18, 1942, and the eggs were to be inspected and ready for shipment on that date. Two provisions for "liquidated damages" were stated: one for delays in delivery, the other for failure to have the products inspected and ready on the specified date. Petitioner failed to have the products ready by May 18, but they were ready before delivery was requested. The government claimed damages on the strength of the second liquidated damages provision, and was upheld in the Court of Claims.[2] On certiorari, *held*, reversed. The provision was for a penalty and therefore void. Four justices dissented. *Priebe & Sons, Inc. v. United States*, (U.S. 1947) 68 S.Ct. 123.

A basic principle of contract law forbids the enforcement of penalty clauses, but allows enforcement of "fair and reasonable attempts to fix just compensation for anticipated loss caused by breach of contract." [3] In order to decide whether a particular provision is for a penalty or for liquidated damages, the contract must be examined as of the time of the making of the contract, not as of the date of breach.[4] In the instant case, the majority of the Court decided that there was no possibility of damages from delay in inspection that would not be covered by the provision for delays in delivery.[5] There was apparent agreement that the provision in the contract under controversy could not be enforced in an ordinary private contract.[6] The divergence of views arose out of the peculiar

be genuine and payment made in good faith. Vilter Mfg. Co. v. Rolaff, (C.C.A. 8th, 1940) 110 F. (2d) 491; National Mut. Ben. Assn. v. Butler, (Tex. Civ. App. 1934) 72 S. W. (2d) 659. But the dispute need not be based upon reasonable grounds: Schuttinger v. Woodruff, 259 N.Y. 212, 181 N.E. 361 (1932).

[1] 22 U.S.C.A. (1947 Supp.) §§ 411 et seq.; 22 U.S.C. (Supp. V, 1946) §§ 411 et seq.; 55 Stat. L. 31 (March 11, 1941).

[2] The decision in the Court of Claims turned largely on the construction of the contract. 65 F. Supp. 457 (1946).

[3] Principal case at 126. 3 WILLISTON, CONTRACTS, rev. ed., §§ 776 et seq. (1936); GRISMORE, CONTRACTS, § 201 (1947); CONTRACTS RESTATEMENT, § 339 (1932).

[4] United States v. Bethlehem Steel Co., 205 U.S. 105, 27 S.Ct. 450 (1907). 3 WILLISTON, CONTRACTS, rev. ed., § 777 (1936); GRISMORE, CONTRACTS, § 201 (1947).

[5] Douglas, J., pointed out (at p. 126) that the provision in question did not cover delays in delivery since those delays were covered by the other liquidated damages provision. Thus the provision in question "can apply only where there was prompt performance when delivery was requested but where prompt delivery could not have been made, due to the absence of the certificates [of inspection], had the request come on the first day when delivery could have been asked. A different situation might be presented had the contract provided for notice to the Government when the certificates were ready."

[6] In his dissenting opinion, Justice Frankfurter states specifically that if the

nature of government contracts.[7] All members of the Court seemed to agree that Congress could provide for penalty clauses in government contracts if it so chose. The problem thus became one of the power or authority of the government contracting agent to include such a provision.[8] Justice Douglas, speaking for the majority, stated that such a power was not to be inferred, but must plainly appear in the authorizing act of Congress. Justice Frankfurter, in an opinion in which the Chief Justice concurred, indicated a willingness to find the authority from the broad statement that the agency was to procure commodities "under appropriate terms and conditions," and from the fact that this was a war-time contract. Justice Black, in an opinion in which Justice Murphy concurred, stated that the power could be found from the fact that Congress had authorized the procurement and had not expressly or impliedly prohibited the inclusion of such a provision in the contract. It would seem that liquidated damages provisions are more liberally construed in government contracts than in private contracts.[9] But the instant case indicates that there must be at least a possibility of damages arising before such provisions will be upheld, in the absence of a Congressional declaration of policy. The Court has adopted the general common law of contracts as the federal law applicable to government transactions, where Congress has not spoken.[10] The result seems desirable and is in accord with earlier decisions involving government contract.

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contract were "to be treated as an ordinary commercial transaction, to be governed by the ordinary rules applicable also to Government contracts in ordinary times, I could not escape the conclusion that the provision . . . operates as a penalty. . . . " (P. 129.) Justice Black did not discuss the point since he did not believe that principles of "general contract law" had any application to the case. He would confine the discussion to the problem of Congressional policy (p. 127). Justice Douglas, on the other hand, has repeatedly stated that common law principles should be applied to government contracts. See the instant case at p. 125, his dissent in United States v. Bethlehem Steel Corp., 315 U.S. 289 at 338, 62 S.Ct. 581 (1942), and his opinion for the Court in United States v. Standard Rice Co., 323 U.S. 106, 65 S.Ct. 145 (1944).

[7] It now seems to be fairly clearly settled that United States government contracts are to be construed under federal law, rather than state law. United States v. Allegheny County, 322 U.S. 174, 64 S.Ct. 908 (1944); United States v. Standard Rice Co., supra, note 6. See particularly the sweeping statement of Justice Jackson in the Allegheny County case at p. 183. This doctrine extends to government commercial paper. National Metropolitan Bank v. United States, 323 U.S. 454, 65 S.Ct. 354 (1945). The problem thus arises of selecting the applicable federal law. See particularly the Clearfield Trust Co. v. United States, 318 U.S. 363, 63 S.Ct. 573 (1943).

[8] Or, stated another way, did Congress authorize the imposition of penalties in contracts with the Federal Surplus Commodities Corporation?

[9] See United States v. Walkof, (C.C.A. 2d, 1944) 144 F. (2d) 75, and the note in 154 A.L.R. 1255 at 1266 (1945).

[10] Compare Erie R. Co. v. Tompkins, 304 U.S. 64, 58 S.Ct. 817 (1938) with the cases cited in note 7; 114 A.L.R. 1500 (1938). See also comment on "federal common law," 59 HARV. L. REV. 966 (1946).