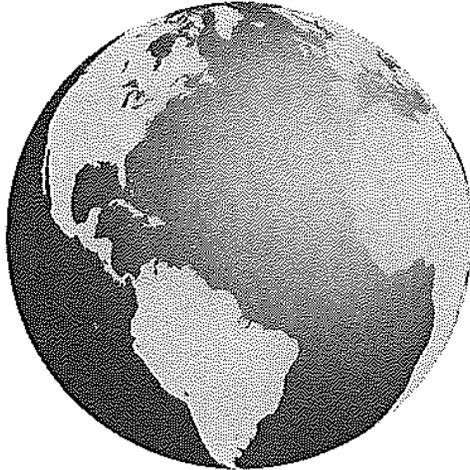


American Contract Law for a Global Age

**Franklin G. Snyder
Mark Edwin Burge**





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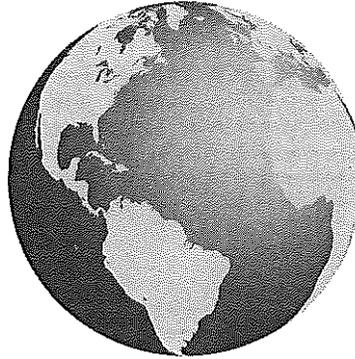
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AMERICAN CONTRACT LAW FOR A GLOBAL AGE

Chapter I: Introduction to Contract Law

Unit 1: Thinking Like a Transactional Lawyer

Unit 2: Thinking Like a Contract Litigator

Unit 1: Thinking Like a Transactional Lawyer

INTRODUCTION TO CONTRACT LAW

Part One

Welcome to Contracts. While a year ago you might have thought that a “tort” was a kind of fruity pastry, most students enter law school with some idea of what a contract is. If we asked you to close your eyes and imagine a contract, what would you see? Maybe you would imagine an old, musty document like the one the dwarves persuaded Bilbo Baggins to sign in the movie, *The Hobbit: An Unexpected Journey*. You might think of a stack of “closing” papers signed by corporate executives completing a multi-billion dollar merger. Or maybe you are reminded of an apartment lease, your internet service provider agreement, or that document the plumber had you sign before fixing your sink.

Promises the Law Will Enforce. As you will discover in this course, a contract need not be a written document at all.¹ Oral contracts are not only enforceable but are in fact ubiquitous. If there is a written document, is that piece of paper the contract? Or is it just evidence that a contract was made? And what’s the difference between those concepts? If the contract is not necessarily the piece of paper, what is it? On second thought, are you confident that you know what a contract is? We had better fix that.

One common definition of a **contract** is that it is (1) a **promise** (or a set of promises) that (2) **the law** (3) will **enforce**.² To “enforce” the contract means to compel the person making the promise (the “promisor”) to either perform it or to pay damages for failing to do so. Enforcement by “the law” means that it will be done by duly authorized agencies of the government through the court system,³ and not by

¹ Except when, for certain reasons in certain cases, the law requires a writing. At this point you should start getting used to the idea that there are very few flat statements about contract law that do not have exceptions. And, sometimes, the exceptions have exceptions.

² See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 1 (1981).

³ Actually, enforcement can be a little more complicated in that it isn’t *only* through the court system. Sometimes parties contractually agree to have a private arbitrator decide their dispute. Parties also sometimes have “self-help” means of enforcement. We will frequently refer to what “courts” and “the court system” do with regard to contracts, but we don’t mean to exclude other players in a complex legal system. We’ve just read so many judicial opinions over the years that we sometimes can’t stop ourselves from talking about courts. (Note: We are only the first unit, and you already should be figuring out that almost every general statement about contract law requires qualification. That, for better or for worse, is part of how lawyers earn their keep. If this stuff were simple, everyone would do it.).

hired Corleone family thugs⁴ or angry mobs with torches.⁵ The really complex part of this definition is *what kind of promises* will the law enforce? It is fair to say that perhaps half of the first-year Contracts course involves aspects of this single question—and professors will routinely complain that they do not have enough time to teach it as thoroughly as they like.

Contracts in Transactional Foresight. An old joke about the traditional law school Contracts course is that students could get through an entire casebook’s worth of material without seeing an actual contract. We don’t want that to happen to you. While the bulk of the course is necessarily made up of legal materials—typically statutes and cases from appellate courts—the contract is always central to the questions involved.

While much of the contract law you will learn in this course will come from cases, most parties don’t anticipate a lawsuit at the time they enter into an agreement. Transactional lawyers have gotten a rap, often unfairly, as being the people who say “no” to a deal getting done. That is because transactional lawyering is forward-thinking. It requires understanding the known situation of the parties, but also considering the many potential unknown futures that might lie ahead. What happens if the deal doesn’t work out as wonderfully as the parties expect? The foresight of a good transactional lawyer can sometimes prevent a future conflict or else put the client in a better situation if a conflict does arise.

Transactional lawyers must thus deal with a contract in the absence of a legal case. We want you to do start the course by doing the same thing. Accordingly, our jumping-off point will be for you to read and consider the transactional agreement in this unit. Along with that document, we have added some comment boxes to provide additional information as you read. After the agreement, you’ll find a series of **Questions for Discussion** that you should (surprise!) be thoroughly prepared to discuss in class. After the questions, you will find a **Problem** that your professor may ask you work or even to turn in. If the goal of law school is to teach you how to “think like a lawyer,” then one of the many goals of this Contracts course is to teach you how to think like a *transactional* lawyer—that is, as someone who has the foresight and practical wisdom to create and draft contracts, not merely to sue over them after they are broken. The questions and problem at the end of this unit are the beginning of our process of learning how to think transactionally.

Without further ado, let us begin Contracts with a very formal-looking and lawyer-drafted document entitled “Surrogate Parenting Agreement.” Read it through carefully. Note that it never once uses the term “contract.” Is it a contract?

⁴ See *generally* THE GODFATHER (Paramount Pictures 1972).

⁵ See, e.g., MARY SHELLY, FRANKENSTEIN (1818).

SURROGATE PARENTING AGREEMENT

THIS AGREEMENT is made this 6th day of February, 1985, by and between MARY BETH WHITEHEAD, a married woman (herein referred to as “Surrogate”), RICHARD WHITEHEAD, her husband (herein referred to as “Husband”), and WILLIAM STERN, (herein referred to as “Natural Father”).

The first paragraph in a contract is its **preamble**. Parties to a contract are usually identified in its preamble.

RECITALS

THIS AGREEMENT is made with reference to the following facts:

(1) WILLIAM STERN, Natural Father, is an individual over the age of eighteen (18) years who is desirous of entering into this Agreement.

Like most contractual **recitals**, the three recitals in this section don’t state any functional terms of agreement. Recitals generally provide the background factual context for a contract. Why are they here if they don’t contain operational provisions that bind the parties?

(2) The sole purpose of this Agreement is to enable WILLIAM STERN and his infertile wife to have a child which is biologically related to WILLIAM STERN.

(3) MARY BETH WHITEHEAD, Surrogate, and RICHARD WHITEHEAD, her husband, are over the age of eighteen (18) years and desirous of entering into this Agreement in consideration of the following:

NOW THEREFORE, in consideration of the mutual promises contained herein and the intentions of being legally bound hereby, the parties agree as follows:

This paragraph contains the **words of agreement** (here, “the parties agree as follows”), so we should expect the actual, operative terms to follow after this paragraph.

1. MARY BETH WHITEHEAD, Surrogate, represents that she is capable of conceiving children. MARY BETH WHITEHEAD understands and agrees that in the best interest of the child, she will not form or attempt to form a parent-child relationship with any child or children she may conceive, carry to term and give birth to, pursuant to the provisions of this Agreement, and shall freely surrender custody to WILLIAM STERN, Natural Father, immediately upon birth of the child; and terminate all parental rights to said child pursuant to this Agreement.

2. MARY BETH WHITEHEAD, Surrogate, and RICHARD WHITEHEAD, her husband, have been married since 12/2/73, and RICHARD WHITEHEAD is in agreement with the purposes, intents and provisions of this Agreement and acknowledges that his wife, MARY BETH WHITEHEAD, Surrogate, shall be artificially inseminated pursuant to the provisions of this Agreement. RICHARD WHITEHEAD agrees that in the best interest of the child, he will not form or attempt to form a parent-child relationship with any child or children MARY BETH WHITEHEAD, Surrogate, may conceive by artificial insemination as

Detailed written contracts often include the central promises of a deal for each party in the first few paragraphs after the words of agreement. These are sometimes known as **subject-matter performance provisions**. These “core” provisions for this agreement are contained in paragraphs 1-4.

described herein, and agrees to freely and readily surrender immediate custody of the child to WILLIAM STERN, Natural Father; and terminate his parental rights; RICHARD WHITEHEAD further acknowledges he will do all acts necessary to rebut the presumption of paternity of any offspring conceived and born pursuant to aforementioned agreement as provided by law, including blood testing and/or HLA testing.

Held in escrow means that a non-party will keep the money until certain specified conditions are met. Why might that be a good idea in a transaction?

3. WILLIAM STERN, Natural Father, does hereby enter into this written contractual Agreement with MARY BETH WHITEHEAD, Surrogate, where MARY BETH WHITEHEAD shall be artificially inseminated with the semen of WILLIAM STERN by a physician. MARY BETH WHITEHEAD, Surrogate, upon becoming pregnant, acknowledges that she will carry said embryo/fetus(s) until delivery. MARY BETH WHITEHEAD, Surrogate, and RICHARD WHITEHEAD, her husband, agree that they will cooperate with any background investigation into the Surrogate's medical, family and personal history and warrants the information to be accurate to the best of their knowledge. MARY BETH WHITEHEAD, Surrogate, and RICHARD WHITEHEAD, her husband, agree to surrender custody of the child to WILLIAM STERN, Natural Father, immediately upon birth, acknowledging that it is the intent of this Agreement in the best interests of the child to do so; as well as institute and cooperate in proceedings to terminate their respective parental rights to said child, and sign any and all necessary affidavits, documents, and the like, in order to further the intent and purposes of this Agreement. It is understood by MARY BETH WHITEHEAD, and RICHARD WHITEHEAD, that the child to be conceived is being done so for the sole purpose of giving said child to WILLIAM STERN, its natural and biological father. MARY BETH WHITEHEAD and RICHARD WHITEHEAD agree to sign all necessary affidavits prior to and after the birth of the child and voluntarily participate in any paternity proceedings necessary to have WILLIAM STERN'S name entered on said child's birth certificate as the natural or biological father.

4. That the consideration for this Agreement, which is compensation for services and expenses, and in no way is to be construed as a fee for termination of parental rights or a payment in exchange for a consent to surrender the child for adoption, in addition to other provisions contained herein, shall be as follows:

The word **consideration** shows up a great deal in contract law. It may not mean what you think it means.

(A) \$10,000 shall be paid to MARY BETH WHITEHEAD, Surrogate, upon surrender of custody to WILLIAM STERN, the natural and biological father of the child born pursuant to the provisions of this Agreement for surrogate services and expenses in carrying out her obligations under this Agreement;

Adjusted for inflation using the Consumer Price Index, \$10,000 in 1985 is worth **\$22,790.30** in 2017 dollars.

(B) The consideration to be paid to MARY BETH WHITEHEAD, Surrogate, shall be deposited with the Infertility Center of New York (hereinafter ICNY), the representative of WILLIAM STERN, at the time of the signing of this Agreement,

and held in escrow until completion of the duties and obligations of MARY BETH WHITEHEAD, Surrogate, (see Exhibit “A” for a copy of the Escrow Agreement), as herein described.

(C) WILLIAM STERN, Natural Father, shall pay the expenses incurred by MARY BETH WHITEHEAD, Surrogate, pursuant to her pregnancy, more specifically defined as follows:

Held in escrow means that a non-party will keep the money until certain specified conditions are met. Why might that be a good idea?

(1) All medical, hospitalization, and pharmaceutical, laboratory and therapy expenses incurred as a result of MARY BETH WHITEHEAD’S pregnancy, not covered or allowed by her present health and major medical insurance, including all extraordinary medical expenses and all reasonable expenses for treatment of any emotional or mental conditions or problems related to said pregnancy, but in no case shall any such expenses be paid or reimbursed after a period of six (6) months have elapsed since the date of the termination of the pregnancy, and this Agreement specifically excludes any expenses for lost wages or other non-itemized incidentals (see Exhibit “B”) related to said pregnancy.

(2) WILLIAM STERN, Natural Father, shall not be responsible for any latent medical expenses occurring six (6) weeks subsequent to the birth of the child, unless the medical problem or abnormality incident thereto was known and treated by a physician prior to the expiration of said six (6) week period and in written notice of the same sent to ICNY, as representative of WILLIAM STERN by certified mail, return receipt requested, advising of this treatment.

In the interest of brevity, we have omitted the numerous Exhibits to the agreement. An exhibit is generally a *standalone document* that the parties want treated as part of the agreement.

(3) WILLIAM STERN, Natural Father, shall be responsible for the total costs of all paternity testing. Such paternity testing may, at the option of WILLIAM STERN, Natural Father, be required prior to release of the surrogate fee from escrow. In the event WILLIAM STERN, Natural Father, is conclusively determined not to be the biological father of the child as a result of an HLA test, this Agreement will be deemed breached and MARY BETH WHITEHEAD, Surrogate, shall not be entitled to any fee. WILLIAM STERN, Natural Father, shall be entitled to reimbursement of all medical and related expenses from MARY BETH WHITEHEAD, Surrogate, and RICHARD WHITEHEAD, her husband.

(4) MARY BETH WHITEHEAD’S reasonable travel expenses incurred at the request of WILLIAM STERN, pursuant to this Agreement.

5. MARY BETH WHITEHEAD, Surrogate, and RICHARD WHITEHEAD, her husband, understand and agree to assume all risks, including the risk of death, which are incidental to conception, pregnancy, childbirth, including but not limited to, postpartum complications. A copy of said possible risks and/or complications is attached hereto and made a part hereof (see Exhibit “C”).

6. MARY BETH WHITEHEAD, Surrogate, and RICHARD WHITEHEAD, her husband, hereby agree to undergo psychiatric evaluation by JOAN EINWOHNER, a psychiatrist as designated by WILLIAM STERN or an agent thereof. WILLIAM STERN shall pay for the cost of said psychiatric evaluation. MARY BETH WHITEHEAD and RICHARD WHITEHEAD shall sign, prior to their evaluations, a medical release permitting dissemination of the report prepared as a result of said psychiatric evaluations to ICNY or WILLIAM STERN and his wife.

7. MARY BETH WHITEHEAD, Surrogate, and RICHARD WHITEHEAD, her husband, hereby agree that it is the exclusive and sole right of WILLIAM STERN, Natural Father, to name said child.

8. "Child" as referred to in this Agreement shall include all children born simultaneously pursuant to the inseminations contemplated herein.

9. In the event of the death of WILLIAM STERN, prior or subsequent to the birth of said child, it is hereby understood and agreed by MARY BETH WHITEHEAD, Surrogate, and RICHARD WHITEHEAD, her husband, that the child will be placed in the custody of WILLIAM STERN'S wife.

10. In the event that the child is miscarried prior to the fifth (5th) month of pregnancy, no compensation, as enumerated in paragraph 4(A), shall be paid to MARY BETH WHITEHEAD, Surrogate. However, the expenses enumerated in paragraph 4(C) shall be paid or reimbursed to MARY BETH WHITEHEAD, Surrogate. In the event the child is miscarried, dies or is stillborn subsequent to the fourth (4th) month of pregnancy and said child does not survive, the Surrogate shall receive \$ 1,000.00 in lieu of the compensation enumerated in paragraph 4(A). In the event of a miscarriage or stillbirth as described above, this Agreement shall terminate and neither MARY BETH WHITEHEAD, Surrogate, nor WILLIAM STERN, Natural Father, shall be under any further obligation under this Agreement.

11. MARY BETH WHITEHEAD, Surrogate, and WILLIAM STERN, Natural Father, shall have undergone complete physical and genetic evaluation, under the direction and supervision of a licensed physician, to determine whether the physical health and well-being of each is satisfactory. Said physical examination shall include testing for venereal diseases, specifically including but not limited to, syphilis, herpes and gonorrhea. Said venereal diseases testing shall be done prior to, but not limited to, each series of inseminations.

12. In the event that pregnancy has not occurred within a reasonable time, in the opinion of WILLIAM STERN, Natural Father, this Agreement shall terminate by written notice to MARY BETH WHITEHEAD, Surrogate, at the residence provided to the ICNY by the Surrogate, from ICNY, as representative of WILLIAM STERN, Natural Father.

13. MARY BETH WHITEHEAD, Surrogate, agrees that she will not abort the children conceived except, if in the professional medical opinion of the inseminating physician, such action is necessary for the physical health of MARY BETH

WHITEHEAD or the child has been determined by said physician to be physiologically abnormal. MARY BETH WHITEHEAD further agrees, upon the request of said physician to undergo amniocentesis (see Exhibit “D”) or similar tests to detect genetic and congenital defects. In the event said test reveals that the fetus is genetically or congenitally abnormal, MARY BETH WHITEHEAD, Surrogate, agrees to abort the fetus upon demand of WILLIAM STERN, Natural Father, in which event, the fee paid to the Surrogate will be in accordance to Paragraph 10. If MARY BETH WHITEHEAD refuses to abort the fetus upon demand of WILLIAM STERN, his obligations as stated in this Agreement shall cease forthwith, except as to obligation of paternity imposed by statute.

14. Despite the provisions of Paragraph 13, WILLIAM STERN, Natural Father, recognizes that some genetic and congenital abnormalities may not be detected by amniocentesis or other tests, and therefore, if proven to be the biological father of the child, assumes the legal responsibility for any child who may possess genetic or congenital abnormalities. (See Exhibits “E” and “F”).

15. MARY BETH WHITEHEAD, Surrogate, further agrees to adhere to all medical instructions given to her by the inseminating physician as well as her independent obstetrician. MARY BETH WHITEHEAD also agrees not to smoke cigarettes, drink alcoholic beverages, use illegal drugs, or take non-prescription medications or prescribed medications without written consent from her physician. MARY BETH WHITEHEAD agrees to follow a prenatal medical examination schedule to consist of no fewer visits than: one visit per month during the first seven (7) months of pregnancy, two visits (each to occur at two-week intervals) during the eighth and ninth month of pregnancy.

16. MARY BETH WHITEHEAD, Surrogate, agrees to cause RICHARD WHITEHEAD, her husband, to execute a refusal of consent form as annexed hereto as Exhibit “G”.

17. Each party acknowledges that he or she fully understands this Agreement and its legal effect, and that they are signing the same freely and voluntarily and that neither party has any reason to believe that the other(s) did not freely and voluntarily execute said Agreement.

18. In the event any of the provisions of this Agreement are deemed to be invalid or unenforceable, the same shall be deemed severable from the remainder of this Agreement and shall not cause the invalidity or unenforceability of the remainder of this Agreement. If such provision shall be deemed invalid due to its scope or breadth, then said provision shall be deemed valid to the extent of the scope or breadth permitted by law.

Paragraph 18 is known as a **severability clause**. It appears in many contracts with the intent of ensuring that the contract will remain in force even if part of it turns out to be legally unenforceable.

19. The original of this Agreement, upon execution, shall be retained by the Infertility Center of New York, with photocopies being distributed to MARY BETH WHITEHEAD,

Surrogate and WILLIAM STERN, Natural Father, having the same legal effect as the original.

/s William Stern
Natural Father
Date 2/6/85

STATE OF NEW YORK) SS:
COUNTY OF NEW YORK)

On the 6th day of February, 1985, before me personally came WILLIAM STERN, known to me, and to me known, to be the individual described in the foregoing instrument and he acknowledged to me that he executed the same as his free and voluntary act.

/s Jane W. Doe
Notary Public

We have read the foregoing five pages of this Agreement, and it is our collective intention by affixing our signatures below, to enter into a binding legal obligation.

/s Mary Beth Whitehead
Surrogate
Date: 1-30-85

/s Richard Whitehead,
Surrogate's Husband
Date: 1-30-85

Each of the parties' signatures on this agreement is accompanied by what is known as an **acknowledgement** in front of a notary public. An acknowledgement isn't a legal requirement, so why would the parties put this in the document?

STATE OF NEW YORK) SS:
COUNTY OF NEW YORK)

On the 6th day of February, 1985, before as personally came MARY BETH WHITEHEAD, known to me, and to me known to be the individual described in the foregoing instrument and she acknowledged to me that she executed the same as her free and voluntary act.

/s Richard Roe
Notary Public

STATE OF NEW YORK) SS:
COUNTY OF NEW YORK)

On the 6th day of February, 1985, before as personally came RICHARD WHITEHEAD, known to me, and to me known to be the individual described in the foregoing instrument and he acknowledged to me that he executed the same me his free and voluntary act.

/s Joseph Bloe
Notary Public

Questions for Discussion

1. This Surrogate Parenting Agreement certainly looks like a contract. Is it? Is there any difference between an “agreement” and a “contract”?
2. This agreement includes three specific people as parties. Why these three? Why is Richard Whitehead here, but not William Stern’s wife (who is referenced, but never by name)? You might want to look at paragraph 2 as you think about this question.
3. Re-read the **words of agreement** paragraph. What does this paragraph state that one or more of the parties might argue about later?
4. You may somewhere have heard the phrase **freedom of contract**, an important concept in American law. But should Mary Beth Whitehead be free to agree to terms like those in paragraph 1? More importantly, should the law enforce what she agreed to here?
5. Consider paragraph 3. Does it matter that the parties specify *artificial* insemination? After all, it might be easier and cheaper to take care of this matter the “natural” way. Can you think of any reasons why this term might affect the legal enforceability of the agreement?
6. Why exactly does the phrase “**best interests of the child**” keep showing up in this document? Is someone intended to read that phrase and be affected by it?
7. The header to paragraph 4 states that the payment to Mary Beth Whitehead is not “to be construed as a fee for termination of parental rights or a payment in exchange for a consent to surrender the child for adoption.” Who exactly isn’t supposed to be construing it that way? And what would happen if that person (or persons) *did* construe it that way?
8. Imagine that the price term in paragraph 4(A) was one dollar. Should that affect the enforceability of this agreement? How about if the term were \$1 million? Should the parties be free to bargain for any price term?
9. In the top part of paragraph 4(C), the parties use the term, “expenses...pursuant to her pregnancy.” The parties then elaborate further on these expenses in the four subparagraphs that follow. Isn’t “expenses...pursuant to her pregnancy” specific enough? Read through the various items in this four-paragraph list and try to determine why those terms made it into the contract. Who benefits or is protected by each term in this list?

10. Consider paragraph 5. Should the Whiteheads really be able to agree to the “risk of death” for Mary Beth? Come to think of it, have *you* signed a document agreeing to the “risk of death”?

11. Why on earth would the psychiatric evaluations for the Whiteheads in paragraph 6 be part of the agreement?

12. Paragraph 9 provides that, in the event of William Stern’s death, the Whiteheads agree that the child will be placed in the custody of Stern’s wife. Do the parties have a right to agree to this term? Can Mrs. Stern, who is not a party to the contract, sue to compel performance if the Whiteheads fail to comply?

13. Notice that both paragraphs 13 and 15 involve Mary Beth Whitehead limiting her right to act in certain ways in the future. Should the legal system, in your view, enforce one, both, or neither of these two paragraphs? If you find one to be enforceable and one not, what kind of a legal rule would you craft that would support your conclusion?

14. Can the parties really, as paragraph 18 provides, sever “any of the provisions” from the agreement and enforce the remainder? Try omitting all of paragraph 4, for example. What provisions could the parties reasonably drop and still retain the benefit of their bargain?

Problem

Problem 1.1

Suppose that you represent either Mary Beth Whitehead or William Stern (your professor may assign you to one party or the other). Think about your client’s position and interests. Draft a list of changes to the Surrogate Parenting Agreement—*at least* five of them—that you, as the attorney would want made on your client’s behalf to improve your client’s situation.

Beside each of your proposals, include two numbers: (1) the likely importance to your client of your proposed change on a one-to-ten scale (with ten being the most important), and (2) the percentage you would estimate your chances are of persuading the other party to accept your proposal in a negotiation of the terms.

Unit 2: Thinking Like a Contract Litigator

INTRODUCTION TO CONTRACT LAW

Part Two

FOCUS OF THIS UNIT

In the previous unit, we considered an agreement from the perspective of a forward-thinking transactional lawyer, seeking to understand what the agreement means and what its legal implications are. Transactional lawyers don't work in a legal vacuum, however. Even the newest contract is affected by the legal environment in which it comes into existence. A twenty-first century practitioner of American contract law must, accordingly, consider that which has come before—cases, statutes, and even the brooding presence of centuries-old English common law. The underlying analytical skills for both a litigator and a transactional lawyer necessarily have a great deal of overlap. Both are working in an environment of pre-existing law.

Looking Backwards. As our ultimate goal is for you to be a well-rounded lawyer, we will now undertake the task set out in this unit—evaluating a transaction *after* the fact. The Surrogate Parenting Agreement from the previous unit did indeed end up in a lawsuit. Two opinions resulting from that litigation follow in this unit and will be instructive to us in understanding the basic issues and outline of the law of contracts. While transactional lawyers are generally forward-looking in their focus, we mustn't lose sight of the fact that thinking about the future requires a solid understanding in what came before. The traditional law school case method of instruction, whatever its faults may be, excels in training lawyers to deconstruct the past.

Just Enough Procedure to Be Dangerous. We think that your Civil Procedure professor is a better source of information about civil procedure than we are. Nonetheless, we'll make some occasional brief diversions into civil procedure when we think it helpful to your understanding of how courts are grappling with matters of contract law (which is a far more interesting subject, in our unbiased opinion).¹ Here is one such diversion.

The two court opinions that follow arise from the agreement we considered in the previous unit. The first opinion is from a trial-level court that considered evidence

¹ Don't tell your Civil Procedure professor we said that. We don't want to cause trouble unless we have a really good reason to do so. An old lawyer's maxim is "Never offend anyone unintentionally."

presented by the parties in a **bench trial**. When we imagine a trial, we usually envision a judge who resolves questions of law while an empaneled jury deliberates and decides disputed facts. In a bench trial, the judge fills both roles and no jury is involved. In this trial court opinion, the judge heard testimony from fact witnesses with personal knowledge of the case—such as the parties to the agreement—as well as from expert witnesses, like psychologists who could opine on matters calling for expertise outside of the law. After the parties have presented their cases in a bench trial, a judge will typically report **findings of fact** (resolving factual issues) and **conclusions of law** (resolving legal issues). Based on those findings and conclusions, a court will render its **final judgment**. While the parties may file various post-trial motions, the final judgment is the point at which parties unhappy with the trial court decision are able to appeal based on alleged error by the lower court.

The second court opinion in this unit is the appeal of the trial court’s decision in the first opinion. Most cases you read in law school are appellate opinions, and the second opinion is one of these, a decision by the New Jersey Supreme Court. As an appellate court, a state supreme court has no ability to engage in its own fact finding. In a sense, the higher court (much like the parties, for that matter) is stuck with the factual determinations by the lower court. An appellate court can, however, fully review the conclusions of law and the *methods* by which the trial court reached its factual conclusions.

As you read these two opinions arising from the same trial and same dispute by the parties, consider the legal bases by which the courts reach their decisions. We especially want you to focus on the role of contract law in the two opinions, including the role that contract law plays in relation to other bodies of law, such as family law and criminal law. Because trial court opinions are less common in law school, we have taken the liberty of adding a few box annotations to help you through it. For the appellate opinion, however, you are on your own. Good luck!



Cases and Materials

IN RE BABY “M”

Superior Court of New Jersey, Bergen County
525 A.2d 1128 (1987), rev’d 537 A.2d 1227 (1988)

SORKOW, P.J.F.P.:²

The primary issue to be determined by this litigation is what are the best interests of a child until now called “Baby M.” All other concerns raised by counsel constitute commentary.

That commentary includes the need to determine if a unique arrangement between a man and woman, unmarried to each other, creates a contract. If so, is the contract enforceable; and if so, by what criteria, means and manner. If not, what are the rights and duties of the parties with regard to custody, visitation and support.

Pay close attention to the questions of contract law raised by the court in this paragraph. You will be grappling versions of these same questions throughout this course.

Jurisdiction

Probably the most important authority of the court is the exercise of its *parens patriae* jurisdiction. Jurisdiction is a word of broad and comprehensive impact. It means the authority by which courts and judicial officers take cognizance of and decide cases. It means the authority to act, to find, define and apply the law.

The court is helpful here to define important terms like **jurisdiction**, as well its Latin legal terminology. Courts are not always so nice, so you should keep a law dictionary handy for terms you don’t know or that are used in an unfamiliar way.

Parens patriae is that power of the sovereign (in this case the State of New Jersey by its judicial branch) to watch over the interests of those who are incapable of protecting themselves. BLACK’S LAW DICTIONARY (4th ed. 1975).

Thus, it is pursuant to N.J. Ct. R. 5:2-1, which defines actions cognizable in the Superior Court, Chancery Division, Family Part, that this court, as the present day successor to a part of that historic legacy of equity jurisdiction, applies said jurisdiction to the issues herein presented; to wit, the best interest of a child and contractual rights, if any, of the litigating parties.

² [“P.J.F.P.” stands for Presiding Judge, Family Part, Chancery Division, New Jersey Superior Court.—Eds.]

Venue

Venue is a concept of place—in this this context, where should a lawsuit be brought. Jurisdiction defines the court’s authority; venue defines in which geographic area the suit should be instituted. Mr. and Mrs. William Stern¹ live in Bergen County, New Jersey. Mr. and Mrs. Richard Whitehead live in Ocean County, New Jersey. The child was taken from Bergen County to Ocean County and returned to Bergen County ultimately from the State of Florida. At the time of the institution of this suit, Mr. and Mrs. Stern believed they had the right to have the child returned to them in Bergen County. They believed “Baby M” was a resident of Bergen County; hence, Mr. and Mrs. Stern began their action here. R.5:2-1 provides that an action involving status of children should be brought in the county of domicile. There never was a challenge to this placement of venue. This court concludes that venue is properly in Bergen County.

Venue of a case is more important than you might think. Parties sometimes get into major fights over the county or district where a lawsuit is heard.

Procedural History

This litigation began on May 5, 1986, when Mr. and Mrs. William Stern filed an ex-parte application for an order to show cause why this court should not issue an order for a summary judgment to enforce a surrogate-parenting contract. The order to show cause was returnable on May 27, 1986.

At the same time a verified complaint was filed seeking to enforce a surrogate-parenting agreement, compel the surrender to plaintiffs of the infant child born to Mrs. Mary Beth Whitehead, restrain any interference with plaintiffs’ custody of the infant, terminate Mrs. Whitehead’s parental rights and allow adoption of the child by Mrs. Stern.

When a court recounts the **procedural history** leading up to its opinion, the context will often help you understand why the court is doing what it is doing. You usually won’t find the main point of the case here, however (unless you’re studying procedure), and we have edited this part down considerably.

[The court describes its decision to appoint a guardian *ad litem* to represent the interests of child independently of the parties.]

On September 2, 1986, Mr. and Mrs. Whitehead filed an answer to the complaint and a counterclaim seeking custody and damages for fraud.

The trial commenced on January 5, 1987.

¹ [By the court] Both Sterns hold Ph.D. degrees. In addition, Mrs. Stern has an M.D. degree. They are both properly called Doctor. However, for clarity, they will be referred to as Mr. Stern and Mrs. Stern.

Findings of Fact, Conclusions of Law and Opinion.

This is a nonjury trial. At law, it is the jury that makes the findings of fact. As in all chancery proceedings, the court is the fact finder.

This court has spent six weeks in the actual trial of the issues before it. The parties, with their 38 expert and lay witnesses, have testified. The admissible evidence has been marked. The testimony and the tangible evidence have been carefully listened to, noted and reviewed by this court. The credibility of the witnesses has been examined, tested and weighed.

The **findings of fact** recounted here are based on the trial judge's consideration and weighing of evidence. Where evidence was in conflict, the judge decides which evidence was more credible. In this opinion, the findings of fact tell the story that led to the agreement we are considering.

This court makes the following findings of fact:

Mr. and Mrs. Stern met when they were both graduate students at the University of Michigan and began dating in 1969. The couple was married in East Lansing, Michigan, on July 27, 1974, by a minister friend of the family. By now each had earned a Ph.D.—Mr. Stern in bio-chemistry and Mrs. Stern in human genetics.

The Sterns had discussed having children prior to and after their marriage but mutually concluded that until Mrs. Stern's pediatric residency was completed, her time to devote to family would be inadequate and thus unfair to the child. It was also concluded that post-residency earnings would make the family more economically secure.

In 1972 and 1978, Mrs. Stern had experienced several episodes of numbness in her fingers and toes and some leg weakness. [Mrs. Stern ultimately was diagnosed with multiple sclerosis, which made the possibility of a pregnancy dangerous to her health.]

The Sterns explored the possibility of adoption but were discouraged in their inquiries. They learned that because they were of different religions and they were an "older couple," adoption of a newborn infant would be extremely difficult. Indeed, the multi-year wait would have them in their very late 30's to early 40's if a child were to become available. Moreover, following the death of William Stern's mother in 1983, the desirability of having his own biological offspring became compelling to William Stern, thus making adoption a less desirable alternative

In 1984, Mr. Stern read an ad from the Infertility Center of New York (hereinafter ICNY) and with the consent of Mrs. Stern, they decided to pursue surrogate parenting. ICNY is an agency that provides surrogate mother candidates to applicants seeking a child through an alternative means of reproduction.

Mary Beth Whitehead is presently 29 years old. [She and Richard Whitehead met and were married in 1973, when she was 16 and he was 24.]

Their first child, Ryan, was born on July 7, 1974. The Whiteheads had their second child, whom they named Tuesday, on January 27, 1976.³ Within several months after their daughter's birth, Richard and Mary Beth Whitehead decided that they did not want to have any more children, that they were "content" with the two children and thought they had the "perfect family." There was mutual agreement that Mr. Whitehead should have a vasectomy to prevent further impregnation of Mrs. Whitehead. The Whiteheads had created their family and wanted no further children.

In or about August or September 1984, Mr. and Mrs. Stern made inquiries into several surrogate parenting programs throughout the United States. Initially, they had hoped to find a woman who would function as a gestational surrogate only; that is, a woman who would be implanted with an egg of Mrs. Stern fertilized by the sperm of Mr. Stern. At that time, however, in vitro fertilization was largely experimental and not a generally available option.

Mr. and Mrs. Stern contacted the Infertility Center of New York and were sent a brochure. The brochure explained in general terms the surrogate parenting procedure and the services which ICNY offered, including the screening of potential surrogate candidates. On December 3, 1984, Mr. Stern entered into an agreement with ICNY.

The **agreement** referenced here is not the document you read in the previous unit. The agreement between Stern and ICNY came earlier.

Over the next several months Mr. and Mrs. Stern were provided with various biographical data concerning potential surrogate candidates. Mr. and Mrs. Stern reviewed the material and attempted to set up interviews with several candidates. They were eventually told of a potential surrogate enrolled in the program who had been unsuccessful working with another couple for approximately eight months. The woman was described as being very dedicated and anxious to work with another couple. The candidate was Mary Beth Whitehead.

Mrs. Whitehead was enrolled in the ICNY surrogate program since the spring 1984. Mrs. Whitehead testified she was motivated to join the program in the hopes of "giving the most loving gift of happiness to an unfortunate couple." Mrs. Whitehead also felt that the surrogate's fee would assist her in providing for her children's long range educational goals. Her signed application also reveals these reasons.

Mrs. Whitehead had learned of surrogate parenting through an advertisement in *The Asbury Park Press*. Mrs. Whitehead spoke of her interest in the surrogacy program to no one other than Mr. Whitehead over the next week. Although Mr. Whitehead was initially opposed to Mrs. Whitehead's involvement in the surrogate program, he ultimately deferred to his wife's wishes. Mrs. Whitehead contacted ICNY and was provided with an application form which she filled out and submitted to the center.

³ [Which, as it happens, was a Tuesday. This is an excellent example of a fact that is interesting, but not legally relevant. Those sometimes happen. – Eds.]

In or about April 1984 Mrs. Whitehead submitted to a psychological evaluation to determine her suitability as a potential surrogate. She was evaluated by interview and testing. The examiner reported that although Mrs. Whitehead expected to have strong feelings about giving up the baby at birth, she was sincere in her plan to become a surrogate mother and has thought extensively about the plan. Although the examiner noted that it would be important to explore with Mrs. Whitehead in more depth whether she would be able to relinquish the child in final analysis, Mrs. Whitehead was recommended as an appropriate candidate for a surrogate volunteer. This report was made for ICNY prior to Mrs. Whitehead working for her first childless couple. It was this fact of prior evaluation that the Sterns relied on. Mrs. Whitehead testified to receiving two counseling sessions at ICNY.

In or about May 1984 ICNY matched Mrs. Whitehead with a married couple (not Mr. and Mrs. Stern) who sought to engage Mrs. Whitehead as a surrogate. The prospective surrogate was presented with a proposed form of surrogate parenting agreement. The proposed agreement was almost identical to the agreement Mrs. Whitehead would later sign with Mr. Stern. As required by the center, she consulted independent counsel on May 24, 1984, who after spending several hours discussing the possible legal ramifications of the agreement with both Mr. and Mrs. Whitehead, negotiated at Mrs. Whitehead's request several minor changes in the contract. The contract was signed by the Whiteheads and shortly thereafter, she began her efforts to conceive by artificial insemination. Her effort for this couple was unsuccessful. She was then introduced to Mr. and Mrs. Stern.

Provisions of a formally-drafted contract are often in **forms** that are replicated from a prior transaction and modified (or not) to fit the needs of the new transaction.

Mr. and Mrs. Stern met with Mr. and Mrs. Whitehead in January 1985 in New Brunswick, New Jersey. The site was chosen because it is approximately mid-way between the respective residences. The parties discussed the proposed surrogacy arrangement and other elements of their contemplated relationship, including Mrs. Whitehead's duty to relinquish custody of the child to Mr. and Mrs. Stern. Mrs. Whitehead made it clear she would not appear on the Sterns' doorstep. All she wanted was an annual picture and letter report of progress. At the conclusion of the meeting, it was agreed that Mrs. Whitehead would be the surrogate mother of a child to be born for Mr. and Mrs. Stern.

On February 6, 1986 Mr. Stern and Mr. and Mrs. Whitehead signed the surrogate parenting agreement. It was in all material respects the same contract that Mrs. Whitehead signed the spring of 1984. At that time, Mr. and Mrs. Whitehead had consulted with an attorney. As already noted, he read and explained the contract to them. Several minor changes were negotiated. Mrs. Whitehead believed the second contract to be as the first and thus, although able to do so, chose not to seek legal advice prior to signing the subject agreement. It is noted with more than passing importance that Mrs. Stern was not a signatory to the agreement.

Subsequent to entering into the surrogate parenting agreement of February 6, 1985, Mrs. Whitehead was inseminated with the seminal fluid of Mr. Stern nine times. Finally, in July 1985 she conceived

[The court recounts at great length what became a tortuous story sensationalized in the nation's tabloids. Baby "M" was born on March 27, 1986. Both before and after the birth, Mrs. Whitehead began to regret her decision. After the birth, she and her husband took the child and fled with their family to Florida, later defying a New Jersey court order. Baby "M" ultimately was taken into custody by Florida authorities on July 31, and returned to New Jersey for the litigation.]

A total of 38 witnesses testified at this trial, 23 fact witnesses and 15 experts.

[The court extensively summarizes the expert testimony, most of which went to the suitability of the parties as parents and the best interest of the child.]

This court is confronted with circumstances in which on February 6, 1985, the parties to this litigation, with great joy and expectation, entered into a surrogate arrangement. It was an arrangement where both—the prospective family and the surrogate mother—wanted the child; albeit, for different purposes. Even though the insemination is artificial, the parental attitude is real. Roger Rosenblatt, *The Baby in the Factory*, TIME (February 14, 1983). The couple sought to bring into existence a child by conscious pre-arrangement which, as far as biologically possible, would be genetically their own. The surrogate consciously chose to bear a child for another couple with the understanding that she would not contest but would consent to their adoption of it.

Expert witnesses differ from fact witnesses in that they do not necessarily have personal knowledge of facts. Instead, their testimony consists of opinion on technical matters to aid the court.

Concerns have been expressed about the efficacy of surrogate arrangements. They are: (1) that the child will not be protected; (2) the potential for exploitation of the surrogate mother; (3) the alleged denigration of human dignity by recognizing any agreement in which a child is produced for money; (4) surrogacy is invalid because it is contrary to adoption statutes and other child benefit laws such as statutes establishing standards for termination of parental rights; (5) it will undermine traditional notions of family; and (6) surrogacy allows an elite economic group to use a poorer group of people to achieve their purposes.

It is argued that the child will not be protected. So long as there is no legislation and some court action in surrogacy arrangements is required, the child born of surrogacy will be protected in New Jersey. If there is compliance with the contract terms, adoption will be necessary; hence, court inquiry about best interests must take place. If there is non-compliance with the contract, as in this case, best interests is still litigated

Pay attention to the **policy concerns** articulated in this paragraph and set out in more detail in the paragraphs following. Although these concerns are specific to the case at hand, they are also representative of broader concerns about contract enforceability we will deal with in this course. At this point, the court has slipped into analysis leading to its **legal conclusions**. You will observe several such conclusions along the way.

with protection to the child, with its own guardian and experts retained to aid the court in its best interests determination.

The second argument against surrogacy is that the surrogate mother will be exploited. To the contrary. It is the private adoption that has that great potential for, if not actual, exploitation of the mother. In the private adoption, the woman is already pregnant. The biological father may be unknown or at best uninterested in his obligations. The woman may want to keep the child but cannot do so for financial reasons. There is the risk of illegal consideration being paid to the mother. In surrogacy, none of these “downside” elements appear. The arrangement is made when the desire and intention to have a family exist on the couple’s part. The surrogate has an opportunity to consult, take advice and consider her act and is not forced into the relationship. She is not yet pregnant.

The third argument is that to produce or deal with a child for money denigrates human dignity. With that premise, this court urgently agrees. The 13th Amendment to the United States Constitution is still valid law. The law of adoption in New Jersey does prohibit the exchange of any consideration for obtaining a child. The fact is, however, that the money to be paid to the surrogate is not being paid for the surrender of the child to the father. And that is just the point—at birth, mother and father have equal rights to the child absent any other agreement. The biological father pays the surrogate for her willingness to be impregnated and carry his child to term. At birth, the father does not purchase the child. It is his own biological genetically related child. He cannot purchase what is already his.

“Neither slavery nor involuntary servitude, except as a punishment for crime whereof the party shall have been duly convicted, shall exist within the United States, or any place subject to their jurisdiction.”
U.S. CONST. AMEND. XIII (ratified 1865)

The fourth argument against surrogacy is that it is a concept running contrary to the laws of adoption in New Jersey. It is in this court’s view that the laws of adoption in this State do not apply to surrogacy contracts. Surrogacy was not a viable procreation alternative and was unknown when the laws of adoption were passed. The same rationale must attach to laws dealing with termination of parental rights. Indeed, it is held that the only concept of law that can presently attach to surrogacy arrangements are contract law principles and *parens patriae* concepts for the benefit of the child. These are the only pole stars available for this court to chart its course on the issues of surrogacy.

The fifth argument against surrogacy is that it will undermine traditional notions of family. How can that be when the childless husband and wife so very much want a child? They seek to make a family. They intend to have a family. The surrogate mother could not make a valid contract without her husband’s consent to her act. This statement should not be construed as antifeminist. It means that if the surrogate is married, her husband will, in all probability, have to sign the contract to establish his non-paternity pursuant to the New Jersey Parentage Law. Both sides of the equation must agree.

The sixth and final argument suggests that an elite upper economic group of people will use the lower economic group of woman to “make their babies.” This argument is insensitive and offensive to the intense drive to procreate naturally and when that is impossible, to use what lawful means are possible to gain a child. This intense desire to propagate the species is fundamental. It is within the soul of all men and women regardless of economic status.

During the course of the testimony offered by the principals to this writing, the court was told on several occasions that a writing was executed by them. Indeed, that writing was marked into evidence. The court was further told by the parties that they all understood their obligations under the contract. Specifically, it was understood by all that Mr. Stern’s sperm would be used to artificially inseminate Mrs. Whitehead. Upon conception, Mrs. Whitehead would carry the child and when she gave birth, she would then surrender the infant to the biological father and his wife. Mrs. Whitehead would also voluntarily renounce her parental rights to permit Mrs. Stern to adopt the infant. Mrs. Stern, it must be noted, is not a party to the contract. This was to avoid any possible inference that there is a violation of N.J. STAT. ANN. § 9:3-54 (which prohibits giving a consideration to obtain an adoptable child). Mr. Whitehead signed a certification pursuant to *Id.* § 9:17-44 establishing his non-paternity. Mr. Stern agreed to pay Mrs. Whitehead \$10,000 for conceiving and bearing his child.

Fundamentally, when there were no time constraints, when Mrs. Whitehead was not pregnant, when each party had the opportunity to obtain advice (legal, medical and/or psychological), the parties expressed their respective offers and acceptances to each other and reduced their understanding to a writing. If the mutual promises were not sufficient to establish a valid consideration, then certainly there was consideration when there was conception. The male gave his sperm; the female gave her egg in their pre-planned effort to create a child—thus, thus, a contract.

For the past year, there has been a child in being. She is alive and well. She is tangible proof of that which the Whiteheads and Mr. Stern in concert agreed to do. The child was conceived with a mutual understanding by the parties of her future life. Except now, Mrs. Whitehead has failed to perform one of her last promises, which was to surrender the child and renounce parental rights. She has otherwise performed the personal service that she had undertaken—conception and carrying the child to term. The terms of the contract have been executed but for the surrender.

A person who has promised is entitled to rely on the concomitant promise of the other promisor. This court holds therefore that in New Jersey, although the surrogacy contract is signed, the surrogate may nevertheless renounce and terminate the contract until the time of conception. She may be subject then for such monetary damages as may be proven. Specific performance to compel the promised conception, gestation, and birth shall not be available to the male promisor. However, once conception has occurred the parties’ rights are fixed, the terms of the contract are firm and performance will be anticipated with the joy that only a newborn can bring.

It is argued that the contract in this case is one of adhesion. It was a writing printed by and supplied by ICNY. That its terms were not immutable is shown by the testimony of the attorney, Saul Radow, who by deposition reported negotiating changes to the written contract; albeit, minor changes. By definition, a contract of adhesion is one in which one party has no alternative but to accept or reject the other party's terms and there are no options by which the party may obtain the product or service. Here, neither party has a superior bargaining position. Each had what the other wanted. A price for the service each was to perform was struck and a bargain reached. One did not force the other. Neither had expertise that left the other at a disadvantage. Neither had disproportionate bargaining power. Although the contract was a form, there is no proof that it was absolute and could not be altered. Defendant offered no proof to this end. Mrs. Whitehead, acknowledged that minor changes were bargained for. There is no evidence of an absence of good faith or fair dealing. This is not a contract of adhesion. *Henningsen v. Bloomfield Motors, Inc.*, 32 N.J. 358 (1960).

At this point, the court begins to consider various **defenses** to contract enforcement raised by the Whiteheads. We will revisit several of these defenses during the course.

Defendants argue unconscionability. They claim the terms are manifestly unfair or oppressive. These terms were known to Mrs. Whitehead from her earlier surrogate contracting experience. She read the second contract, albeit briefly, prior to signing it. She was aware of her compensation. She had been pregnant before and had to be aware of the risks of pregnancy. Her obligation included physical examination for her own welfare as well as the welfare of the fetus. Mrs. Whitehead says that Mr. Stern undertook no risks. To compare the risk of pregnancy in a woman to the donation of sperm by the man would be unconscionable. This, however, is the bargain Mrs. Whitehead sought and obtained. Mr. Stern did take a risk, however, whether the child would be normal or abnormal, whether accepted or rejected he would have a lifetime obligation and responsibility to the child as its natural and biological father.

To the issue of unconscionability, defendants fail to show proof of overreaching or disproportionate bargaining that result in an unfair contract. Mrs. Whitehead was anxious to contract. At the New Brunswick meeting, she pressed for a definitive statement by the Sterns. She knew just what she was bargaining for. This court finds that she has changed her mind, reneged on her promise and now seeks to avoid her obligations. Unconscionability claims arise, more often than not, in consumer contracts for products or services. The seller is in the dominant position and the buyer must comply or there is no deal. Not so here—either party could have walked away from the other. Either party would then have continued on ICNY's roster of available surrogates and childless families seeking a surrogate. They chose not to do so. The bargain here was one for totally personal service. It was a very scarce service Mrs. Whitehead was providing. Indeed, it might even be said she had the dominant bargaining position for without her Mr. Stern had no other immediate source available. Each party sought each other to fulfill their needs.

It is argued by *amicus* that the \$ 10,000 to be paid Mrs. Whitehead is so low as to be unconscionable. In counterpoint, it is stated that not all services can be compensated by money. Millions of men and women work for each other in their marital relationship. There may even be mutual inequality in the value of the work performed but the benefits obtained from the relationship serve to reject the concept of equating societal acts to a monetary balancing. Perhaps the risk was great for the money to be paid but the risk was what Mrs. Whitehead chose to assume and at the agreed upon fee. And it is assumed she received other intangible benefits and satisfaction from doing what she did. Her original application set forth her highly altruistic purpose. Notwithstanding *amicus*' position, all in this world cannot be equated to money.

It is defendants' claim of unconscionability. They must show such unfairness, overreaching, bargaining disparity or patent unfairness that no reasonable person acting without duress would accept the contract terms. *Toker v. Westerman*, 113 N.J. Super. 452, 454 (Cty. D. Ct.1970). This, defendants have failed to do.

Defendants next claim relief from the contract because the Whiteheads had no attorney at the time they entered the contract. It is hornbook law that any person who possesses legal capacity may be bound by a contract even when it is entered without representation unless there is fraud, overreaching or undue influence which caused the party to enter the contract.

It was Dr. Vetter, one of defendants' own psychiatrists, who testified unequivocally that the Whiteheads had legal capacity to contract. There were no mental disabilities. They understood what they were doing. They understood the contract terms. That there was capacity to contract was proven by a preponderance of the credible evidence. Furthermore, Mr. Whitehead testified they signed the contract at their New Jersey home because they did not wish to travel to New York. Their prior counsel was available to them. They chose not to call him. It is well settled that disparity of education or sophistication is not considered grounds for avoidance of a contract. *Dundee Chemical Works v. Connor*, 46 N.J. Eq. 576 (E. & A.1890). In *Dundee*, the adversaries were a homemaker-executrix and an attorney. The Court held it would not weigh the disparate skills to void a contract. This leaves just fraud, undue influence or illegality. As to the latter two factors this court says no evidence has been shown of illegality or undue influence. This court has a sense that Mrs. Whitehead would be a very difficult person to unduly influence once her mind is made up.

As to the claim of fraud, defendants allege they may rescind the contract because of the fraud perpetrated by plaintiffs. The court first defines the terms with which we are to treat. Legal fraud has four elements: (1) a material misrepresentation of a fact; (2) known to be false; (3) upon which a party relied; and (4) to its damage. Equitable fraud eliminates the element of knowledge. Thus, even if the promisor did not know of the fact being false, it would be inequitable to permit contractual recovery and the injured party should be allowed the option to sustain the contract or rescind. *Jewish Center of Sussex County v. Whale*, 86 N.J. 619 (1981).

[The court concludes that no false statements were made.]

There is no fraud, legal or equitable, that would allow Mr. and Mrs. Whitehead to rescind their contract.

It is further argued that the contract is illusory; that is to say, that only one of the parties has an obligation, the other only benefits, that there is no mutuality of obligation. This does not mean equality of obligation. *See Friedmann v. Tappan Development Corp.*, 22 N.J. 523 (1956); SAMUEL WILLISTON, THE LAW OF CONTRACTS, § 105A at 421. Such is not the case. Mr. Stern gave his sperm; Mrs. Whitehead gave her egg. Together the miracle of a new life was obtained. Mrs. Whitehead argues Mr. Stern does not have to take the child under certain circumstances which have not happened and are not before this court. She is arguing, hypothetically, “if.” It is suggested again that this court is dealing with the facts before it. Even assuming *arguendo*, that the court were to address the issue of the illusory contract as stated by defendants, the conclusion would be the same. The Whiteheads argue that Mr. Stern does not have to take the baby if it is imperfect; but the fact is the contract does provide that there is an obligation and responsibility, that there is a life long responsibility by Mr. Stern for the child’s support and welfare. The contract is not illusory.

[The court analyzes the question whether there is a right to assisted reproduction under the U.S. Constitution.]

For the foregoing reasons, this court concludes and holds that the surrogate-parenting agreement is a valid and enforceable contract pursuant to the laws of New Jersey. . . . This court further finds that Mrs. Whitehead has breached her contract in two ways: (1) by failing to surrender to Mr. Stern the child born to her and Mr. Stern and (2) by failing to renounce her parental rights to that child.

What are the remedies available to the plaintiff? The remedies that exist for breach of a contract are an award of money damages or specific enforcement of the terms of the contract. There are, of course, other remedies but they are neither relevant nor applicable here. Monetary damages cannot possibly compensate plaintiff for the loss of his bargain because of defendant’s breach. The singular subject of the contract further mitigates against an award of damages.

Plaintiff acknowledges that before the remedy of specific performance can be used it must be shown that the contract was entered into with understanding and free will. Dr. Vetter, the Whitehead psychiatric expert, testified that the Whiteheads were competent when the contract was signed and they understood the terms. It must also be shown that the contract was entered in good faith, without fraud and is not unenforceable because of public policy. By reason of the findings heretofore made, to wit: there is no evidence of fraud and the parties voluntarily entered the agreement, indeed they were all very anxious to do so, such contracts are not contrary to public policy. Indeed New Jersey has

Remedies will be another significant issue in our study of contract law. Legal rights arising from a contract breach are not terribly useful unless the law provides a remedy for the breach.

no stated public policy on surrogacy. There is no reason why this court should not order specific performance.

Specific performance is a discretionary remedy. It should only be exercised in accordance with principles of equity. In each case the evaluation of the equities must be left to the judgment and good conscience of the trial court. *Stehr v. Sawyer*, 40 N.J. 352 (1963). This means that the court must adjudge and weigh whether the parties' conduct was fair and reasonable. Will the relief afforded by the remedy be unreasonable? If specific performance is ordered, the result will be just what the parties bargained for and the contract contemplated. Mr. Stern wanted progeny, a child. Mrs. Whitehead wanted to give the child she would bear to a childless couple. His sperm fertilized her egg. A child was born. Until the child was placed in his home he never knew the stress and bliss, the responsibilities and rewards of a child. The Whiteheads have two children. They did not want any more. Theirs was the perfect family, Mr. Whitehead testified. The Whiteheads agreed that Mr. Whitehead should get a vasectomy to prevent further conception. It is suggested that Mrs. Whitehead wanted a baby, now that she is older than when her first two children were born, to experience and fulfill herself again as a woman. She found the opportunity in a newspaper advertisement. She received her fulfillment. Mr. Stern did not.

The **judgment**, contained in the numbered item list at this point, is the substantive final result of the trial court's reasoning stated up until this point. A **final judgment** is often the first point at which a trial court's decision may be appealed to a higher court based on specific alleged errors.

At this point the court would enter its order for specific performance, but an additional inquiry is necessary. Since we here deal with a human life of only one year, since we treat with, as the guardian ad litem has said "the most precious and unique thing on this earth, a small vulnerable and lovable child," inquiry must be made to determine if the result of such an order for specific performance would be in the child's best interest. This court holds that whether there will be specific performance of this surrogacy contract depends on whether doing so is in the child's best interest. . . .

[The court extensively reviews the evidence and concludes that the child's best interest is to be with the Sterns.]

This court enters judgment in favor of plaintiffs as follows:

- (1) The surrogate parenting agreement of February 6, 1985, will be specifically enforced.
- (2) The prior order of the court giving temporary custody to Mr. Stern is herewith made permanent. Prior orders of visitation are vacated.
- (3) The parental rights of defendant Mary Beth Whitehead are terminated.
- (4) Mr. Stern is formally adjudged the father of Melissa Stern.
- (5) The New Jersey Department of Health, Bureau of Vital Statistics and its ancillary and/or subordinate state or county agencies are directed to amend all records of birth to reflect the paternity and name of the child to be Melissa Stern.

(6) Defendants, Mary Beth Whitehead, Richard Whitehead, Joseph Messer and Catherine Messer, their relatives, friends, agents, servants, employees or any person acting for and/or on their behalf are restrained from interfering with the parental and custodial rights of plaintiff, his wife or their agents, servants, employees or any other persons acting for and/or on their behalf.

(7) As heretofore ordered unpleaded claims for money damages are reserved to plaintiffs.

(8) Counsel for plaintiffs will submit a certification of services pursuant to R. 4:42-9 in support of their application for counsel fees.

(9) The court will enter judgment against defendants on all prayers for relief in the first and second counts of their counterclaim.

(10) The guardian ad litem shall file a certification of services pursuant to R. 4:42-9 to support her application for fees. She shall also submit to the court the statements of fees from her experts for allocation by the court.

(11) The sum of \$ 10,000, being held by the Clerk of the Superior Court, shall be the property of Mary Beth Whitehead.

(12) The guardian ad litem shall be discharged herewith except for the purposes of appeal.

Review Question 1. The trial court states that it “was further told by the parties that they all understood their obligations under the contract.” Why can’t we just end the inquiry there? What, based on this opinion, do you now understand to be the elements of an enforceable contract?

Review Question 2. The court notes that “Mr. and Mrs. Whitehead had consulted with an attorney” when they signed the 1984 agreement with a prior couple. Why does that matter? Can’t parties enter into contracts without attorneys being involved? What value—if any—can attorneys add to the process of contracting?

Review Question 3. The court observes that the “remedies that exist for breach of a contract are an award of money damages or specific enforcement of the terms of the contract.” Which type of remedy does the trial court enforce and why?

IN RE BABY M
Supreme Court of New Jersey
537 A.2d 1227, 109 N.J. 396 (1988)

WILENTZ, C.J., delivered the opinion of the Court:

In this matter the Court is asked to determine the validity of a contract that purports to provide a new way of bringing children into a family. For a fee of \$10,000, a woman agrees to be artificially inseminated with the semen of another woman's husband; she is to conceive a child, carry it to term, and after its birth surrender it to the natural father and his wife. The intent of the contract is that the child's natural mother will thereafter be forever separated from her child. The wife is to adopt the child, and she and the natural father are to be regarded as its parents for all purposes. The contract providing for this is called a "surrogacy contract," the natural mother inappropriately called the "surrogate mother."

We invalidate the surrogacy contract because it conflicts with the law and public policy of this State. While we recognize the depth of the yearning of infertile couples to have their own children, we find the payment of money to a "surrogate" mother illegal, perhaps criminal, and potentially degrading to women. Although in this case we grant custody to the natural father, the evidence having clearly proved such custody to be in the best interests of the infant, we void both the termination of the surrogate mother's parental rights and the adoption of the child by the wife/stepparent. We thus restore the "surrogate" as the mother of the child. We remand the issue of the natural mother's visitation rights to the trial court, since that issue was not reached below and the record before us is not sufficient to permit us to decide it *de novo*.

We find no offense to our present laws where a woman voluntarily and without payment agrees to act as a "surrogate" mother, provided that she is not subject to a binding agreement to surrender her child. Moreover, our holding today does not preclude the Legislature from altering the current statutory scheme, within constitutional limits, so as to permit surrogacy contracts. Under current law, however, the surrogacy agreement before us is illegal and invalid.

[The court recites some of the facts stated in the trial court opinion above.]

The Sterns claim that the surrogacy contract is valid and should be enforced, largely for the reasons given by the trial court.

We have concluded that this surrogacy contract is invalid. Our conclusion has two bases: direct conflict with existing statutes and conflict with the public policies of this State, as expressed in its statutory and decisional law.

Conflict With Statutory Provisions

One of the surrogacy contract's basic purposes, to achieve the adoption of a child through private placement, though permitted in New Jersey "is very much disfavored." *Sees v. Baber*, 377 A.2d 628 (N.J. 1977). Its use of money for this

purpose—and we have no doubt whatsoever that the money is being paid to obtain an adoption and not, as the Sterns argue, for the personal services of Mary Beth Whitehead—is illegal and perhaps criminal. N.J. Stat. Ann. § 9:3-54.⁴ In addition to the inducement of money, there is the coercion of contract: the natural mother's irrevocable agreement, prior to birth, even prior to conception, to surrender the child to the adoptive couple. Such an agreement is totally unenforceable in private placement adoption.

Integral to these invalid provisions of the surrogacy contract is the related agreement, equally invalid, on the part of the natural mother to cooperate with, and not to contest, proceedings to terminate her parental rights, as well as her contractual concession, in aid of the adoption, that the child's best interests would be served by awarding custody to the natural father and his wife—all of this before she has even conceived, and, in some cases, before she has the slightest idea of what the natural father and adoptive mother are like.

The surrogacy contract conflicts with: (1) laws prohibiting the use of money in connection with adoptions; (2) laws requiring proof of parental unfitness or abandonment before termination of parental rights is ordered or an adoption is granted; and (3) laws that make surrender of custody and consent to adoption revocable in private placement adoptions.

(1) Our law prohibits paying or accepting money in connection with any placement of a child for adoption. Violation is a high misdemeanor. Excepted are fees of an approved agency (which must be a non-profit entity) and certain expenses in connection with childbirth.

Considerable care was taken in this case to structure the surrogacy arrangement so as not to violate this prohibition. The arrangement was structured as follows: the adopting parent, Mrs. Stern, was not a party to the surrogacy contract; the money paid to Mrs. Whitehead was stated to be for her services—not for the

⁴ *[By the court]* N.J. STAT. ANN. § 9:3-54 reads as follows:

a. No person, firm, partnership, corporation, association or agency shall make, offer to make or assist or participate in any placement for adoption and in connection therewith

(1) Pay, give or agree to give any money or any valuable consideration, or assume or discharge any financial obligation; or

(2) Take, receive, accept or agree to accept any money or any valuable consideration.

b. The prohibition of subsection a. shall not apply to the fees or services of any approved agency in connection with a placement for adoption, nor shall such prohibition apply to the payment or reimbursement of medical, hospital or other similar expenses incurred in connection with the birth or any illness of the child, or to the acceptance of such reimbursement by a parent of the child.

c. Any person, firm, partnership, corporation, association or agency violating this section shall be guilty of a high misdemeanor.

adoption; the sole purpose of the contract was stated as being that “of giving a child to William Stern, its natural and biological father”; the money was purported to be “compensation for services and expenses and in no way . . . a fee for termination of parental rights or a payment in exchange for consent to surrender a child for adoption”; the fee to the Infertility Center (\$7,500) was stated to be for legal representation, advice, administrative work, and other “services.” Nevertheless, it seems clear that the money was paid and accepted in connection with an adoption.

The Infertility Center's major role was first as a “finder” of the surrogate mother whose child was to be adopted, and second as the arranger of all proceedings that led to the adoption. Its role as adoption finder is demonstrated by the provision requiring Mr. Stern to pay another \$7,500 if he uses Mary Beth Whitehead again as a surrogate, and by ICNY's agreement to “coordinate arrangements for the adoption of the child by the wife.” The surrogacy agreement requires Mrs. Whitehead to surrender Baby M for the purposes of adoption. The agreement notes that Mr. and Mrs. Stern wanted to have a child, and provides that the child be “placed” with Mrs. Stern in the event Mr. Stern dies before the child is born. The payment of the \$10,000 occurs only on surrender of custody of the child and “completion of the duties and obligations” of Mrs. Whitehead, including termination of her parental rights to facilitate adoption by Mrs. Stern. As for the contention that the Sterns are paying only for services and not for an adoption, we need note only that they would pay nothing in the event the child died before the fourth month of pregnancy, and only \$1,000 if the child were stillborn, even though the “services” had been fully rendered. Additionally, one of Mrs. Whitehead's estimated costs, to be assumed by Mr. Stern, was an “Adoption Fee,” presumably for Mrs. Whitehead's incidental costs in connection with the adoption.

Mr. Stern knew he was paying for the adoption of a child; Mrs. Whitehead knew she was accepting money so that a child might be adopted; the Infertility Center knew that it was being paid for assisting in the adoption of a child.

The prohibition of our statute is strong. Violation constitutes a high misdemeanor, a third-degree crime, carrying a penalty of three to five years imprisonment.

(2) The termination of Mrs. Whitehead's parental rights, called for by the surrogacy contract and actually ordered by the court, fails to comply with the stringent requirements of New Jersey law. [The court notes that under the law a birth mother's rights can be terminated only upon surrender to a State-designated agency after certain procedural steps are followed, or upon a showing that the parent is manifestly unfit and would actually be a danger to the child. As the surrender was made in a contract and not to a State-designated agency, and Mrs. Whitehead had not been found unfit, her parental rights had not been validly terminated despite the contract.]

Since the termination was invalid, it follows, as noted above, that adoption of Melissa by Mrs. Stern could not properly be granted.

The trial court required a "best interests" showing as a condition to granting specific performance of the surrogacy contract. Having decided the "best interests" issue in favor of the Sterns, that court's order included, among other things, specific performance of this agreement to surrender custody and terminate all parental rights.

The trial court's award of specific performance therefore reflects its view that the consent to surrender the child was irrevocable. We accept the trial court's construction of the contract; indeed it appears quite clear that this was the parties' intent. Such a provision, however, making irrevocable the natural mother's consent to surrender custody of her child in a private placement adoption, clearly conflicts with New Jersey law.

Contractual surrender of parental rights is [prohibited] in our statutes as now written. [The court at this point describes the prohibition contained in the New Jersey Parentage Act in more detail.]

Public Policy Considerations

The surrogacy contract's invalidity, resulting from its direct conflict with the above statutory provisions, is further underlined when its goals and means are measured against New Jersey's public policy. The contract's basic premise, that the natural parents can decide in advance of birth which one is to have custody of the child, bears no relationship to the settled law that the child's best interests shall determine custody. The fact that the trial court remedied that aspect of the contract through the "best interests" phase does not make the contractual provision any less offensive to the public policy of this State.

The surrogacy contract guarantees permanent separation of the child from one of its natural parents. Our policy, however, has long been that to the extent possible, children should remain with and be brought up by both of their natural parents. That was the first stated purpose of the previous adoption act: "it is necessary and desirable to protect the child from unnecessary separation from his natural parents." While not so stated in the present adoption law, this purpose remains part of the public policy of this State. This is not simply some theoretical ideal that in practice has no meaning. The impact of failure to follow that policy is nowhere better shown than in the results of this surrogacy contract. A child, instead of starting off its life with as much peace and security as possible, finds itself immediately in a tug-of-war between contending mother and father.⁵

⁵ [By the court] And the impact on the natural parents, Mr. Stern and Mrs. Whitehead, is severe and dramatic. The depth of their conflict about Baby M, about custody, visitation, about the goodness or badness of each of them, comes through in their telephone conversations, in which each tried to persuade the other to give up the child. The potential adverse consequences of surrogacy are poignantly captured here -- Mrs. Whitehead threatening to kill herself and the baby, Mr. Stern begging her not to, each blaming the other. The dashed hopes of the Sterns, the agony of Mrs. Whitehead, their suffering, their hatred—all were caused by the unraveling of this arrangement.

The surrogacy contract violates the policy of this State that the rights of natural parents are equal concerning their child, the father's right no greater than the mother's. "The parent and child relationship extends equally to every child and to every parent, regardless of the marital status of the parents." N.J. STAT. ANN. § 9:17-40. The whole purpose and effect of the surrogacy contract was to give the father the exclusive right to the child by destroying the rights of the mother.

The policies expressed in our comprehensive laws governing consent to the surrender of a child, stand in stark contrast to the surrogacy contract and what it implies. Here there is no counseling, independent or otherwise, of the natural mother, no evaluation, no warning.

The only legal advice Mary Beth Whitehead received regarding the surrogacy contract was provided in connection with the contract that she previously entered into with another couple. Mrs. Whitehead's lawyer was referred to her by the Infertility Center, with which he had an agreement to act as counsel for surrogate candidates. His services consisted of spending one hour going through the contract with the Whiteheads, section by section, and answering their questions. Mrs. Whitehead received no further legal advice prior to signing the contract with the Sterns.

Mrs. Whitehead was examined and psychologically evaluated, but if it was for her benefit, the record does not disclose that fact. The Sterns regarded the evaluation as important, particularly in connection with the question of whether she would change her mind. Yet they never asked to see it, and were content with the assumption that the Infertility Center had made an evaluation and had concluded that there was no danger that the surrogate mother would change her mind. From Mrs. Whitehead's point of view, all that she learned from the evaluation was that "she had passed." It is apparent that the profit motive got the better of the Infertility Center. Although the evaluation was made, it was not put to any use, and understandably so, for the psychologist warned that Mrs. Whitehead demonstrated certain traits that might make surrender of the child difficult and that there should be further inquiry into this issue in connection with her surrogacy. To inquire further, however, might have jeopardized the Infertility Center's fee. The record indicates that neither Mrs. Whitehead nor the Sterns were ever told of this fact, a fact that might have ended their surrogacy arrangement.

Under the contract, the natural mother is irrevocably committed before she knows the strength of her bond with her child. She never makes a totally voluntary, informed decision, for quite clearly any decision prior to the baby's birth is, in the most important sense, uninformed, and any decision after that, compelled by a pre-existing contractual commitment, the threat of a lawsuit, and the inducement of a \$ 10,000 payment, is less than totally voluntary. Her interests are of little concern to those who controlled this transaction.

Although the interest of the natural father and adoptive mother is certainly the predominant interest, realistically the only interest served, even they are left

with less than what public policy requires. They know little about the natural mother, her genetic makeup, and her psychological and medical history. Moreover, not even a superficial attempt is made to determine their awareness of their responsibilities as parents.

Worst of all, however, is the contract's total disregard of the best interests of the child. There is not the slightest suggestion that any inquiry will be made at any time to determine the fitness of the Sterns as custodial parents, of Mrs. Stern as an adoptive parent, their superiority to Mrs. Whitehead, or the effect on the child of not living with her natural mother.

This is the sale of a child, or, at the very least, the sale of a mother's right to her child, the only mitigating factor being that one of the purchasers is the father. Almost every evil that prompted the prohibition on the payment of money in connection with adoptions exists here.

Review Question 4. Compare the first paragraph of the supreme court's opinion with the story told in the trial court's findings of fact. To what extent does the way the story is framed impact the way you think about the case? Do judges have an audience for which they are writing, and if so, who is it?

Review Question 5. Under the heading "Public Policy Considerations," the New Jersey Supreme Court articulates reasons not to enforce the parties' agreement. How do these policy concerns differ from those stated by the trial court? What explains the fact that two trained and experienced opinion-writing judges reached such different results based on the exact same facts? Is "public policy" just another way of saying "in my opinion"?

Problems

Donald Donor is a single, 29-year-old former factory assembly-line worker with a high school education and no children. He has been out of work for just over a year since the factory where he was employed closed and moved overseas. Patricia Poorhealth is a 46-year old vice president with an area technology company who has become a millionaire during the past decade. Patricia is, however, suffering from a kidney disease that, absent a transplant, is likely (roughly 80% statistical probability) to be fatal within the next three years. Patricia has two children with her 49-year old husband Harold—daughter Alicia, age 8, and son Barney, age 5.

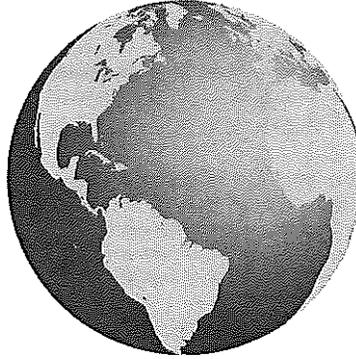
Donald has been selling plasma at a local blood bank to make ends meet. During a recent visit, he agreed, in exchange for a \$20 bonus, to be tested for organ donor compatibility. As it happens, Donald has two healthy kidneys and his physiology is compatible with Patricia for purposes of a transplant. Accordingly, Patricia has contacted Donald and offered to pay him \$100,000 plus all medical expenses in exchange for donating a kidney to her. Though he has a few misgivings about surgery, Donald is pleased at the prospect of earning this money, more than he has seen in one place his entire life. For her part, Patricia can't restrain herself from tears of joy at the prospect of living long enough to raise her children to adulthood.

Problem 2.1

If the opinion of the New Jersey trial court in the *Baby M* case represents controlling law in your jurisdiction, would the contract be contemplated by Donald and Patricia be enforceable? Why or why not? How, if at all, would your answer change if the New Jersey Supreme Court's *Baby M* opinion is the controlling law of your jurisdiction?

Problem 2.2

Regardless of your answers to Problem 2.1, assume now that Donald and Patricia's agreement is an enforceable contract. If, one month after signing the contract, one of the parties decides to breach, what would the remedy be for the non-breaching party? Consider the discussion of remedies in both of the *Baby M* opinions as you formulate your answer.



AMERICAN CONTRACT LAW FOR A GLOBAL AGE

Chapter II: Contract Formation

Unit 3: Agreement to Contract

Unit 4: Offers to Contract

Unit 5: Problems With Offers

Unit 6: Acceptance

An Introduction to CONTRACT FORMATION

Did the Parties Consent? A contract is, put simply, an *agreement* between two or more private parties creating obligations that *the law will enforce*. Unlike obligations imposed under criminal law and tort law—which generally do not depend on whether you have agreed to be bound to the rules—the obligations in contract law are, at least in theory, voluntary. That is, you are bound to do a certain thing not because the law makes everyone to do it, but because you personally have promised another person to do it. Thus, it is usually important in analyzing contract questions to determine what the parties *agreed* to do for each other. That agreement becomes *consent* to be bound. Most of the time, this isn't much of a problem. When you hit the “buy” button on a screen or hand over money to a cashier, one could easily to assume that you are intending to buy some sort particular good or service, that the seller intends you to have it, and that both of you expect to be bound. Generally the transaction goes on perfectly well. Similarly, in a real estate purchase, there are extensive written documents that are signed by both parties, often with legal counsel involved. When two parties have signed “on the dotted line” to the same piece of paper, it is not hard to find agreement.

Transactions are, however, sometimes not that simple or that formal. Sometimes the alleged contract has been formed through the exchange of communications, but there is no one single moment when both parties seem to be agreeing on exactly the same thing at exactly the same time. In the modern world, such situations occur with some frequency. We therefore need some way to determine if the communications exchanged by the parties demonstrate sufficient agreement that will (if supported by consideration) create an enforceable contract. This part of contract law is often called “formation” or “offer and acceptance.”

Unit 3: Agreement to Contract

CONTRACT FORMATION Part One

Mutual Assent

In a dispute alleging breach of contract, sometimes the parties do not agree that there was any agreement at all. Such claims can arise from the fact that language, while usually reliable, is not always a perfect means of communication. Conduct intended to indicate one thing may be taken to indicate something very different. People negotiating a transaction may come from different backgrounds, possess different information, have different understandings, or use words in different ways. Anyone who has ever been compelled in a discussion to exclaim, “But that’s not what I *meant!*” can understand this problem.

Subjective or Objective Understanding? But the problem in using “agree” or “consent” is that human beings in general (and judges and juries in particular) are not good at reading minds. As in ordinary affairs, they usually try to determine what someone intended by looking at what they said and did.¹ The earliest American contract cases, for example, seemed completely uninterested in what parties themselves thought about the transaction. In cases like *Murray v. Bethune*, 1 Wend. 191 (N.Y. 1828), courts held that a party’s subjective understanding of the deal was actually irrelevant to the question whether he had reached an agreement. Indeed, a party was not even permitted to testify at trial as to what he *understood* a contract to mean. “The mere understanding of one of the parties to the agreement,” said the *Murray* court, “without such understanding having been communicated or assented to by the other party, could not be given in evidence in order to make out the contract or agreement between them.”

Continental European Influence. This refusal to consider what the parties actually thought might seem harsh. If contracts are to be voluntary obligations, shouldn’t it be relevant that a party really did not understand that had agreed to a

¹ [Consider an extreme case in a criminal law setting. If *A* shoots *B* six times in the back with a revolver, yelling “Good riddance, sucker!”—and then reloads before firing six more shots at *B*, we can *infer* that *A* intended to kill *B*. We would not need any extra evidence of his actual mental thoughts in order to reach our conclusion.—Eds.]

particular obligation? In Europe, influenced particularly by French jurisprudence, the answer began to be (at least sometimes) “yes.” And just as French philosophy had influenced America’s founding generation, French legal thinkers—particularly

Robert Joseph Pothier²—began to influence American law with what came to be called the “will” theory of contract. The will theory (the term itself is a later invention, but it is accurate enough) held that obligations had to be knowingly and voluntarily assumed before they were binding. Some early signs of this appear when some American courts, such as the New York judges in *Mactier’s Administrators v. Frith*, 6 Wend. 103 (N.Y. 1830), introduce the idea of a necessary “meeting of the minds” of the two parties.

The Peerless British Influence. American developments were pushed farther down this road by changes brewing on the other side of the Atlantic. In the 19th century, Great Britain was the world’s greatest commercial empire, and London was the legal center of the commercial world. Notwithstanding the American Revolution and independence of the United States, British cases remained highly influential in American courts for well over a century due to the two countries’ shared common-law heritage. Toward the end of the American Civil War, the British Court of Exchequer announced its decision in a case called *Raffles v. Wichelhaus*, 159 Eng. Rep. 375 (Exch. 1864), which had enormous impact on both sides of the Atlantic.

In *Raffles*, a cotton buyer in England contracted with a seller in India to purchase a load of cotton. The contract provided that the cotton would be shipped “ex *Peerless*”—that is, in the terminology of the day, aboard a ship called the *Peerless*. In one of the strangest coincidences in legal history—most likely unknown to the parties at a time before telegraph communication was available—it turned out that there were *two* ships called *Peerless* in India, both of which were going to be carrying cotton to England, one sailing from India in October and one sailing in December. When the December *Peerless* arrived, the seller tried to deliver the cotton it carried to the buyer, but the buyer refused to take it, claiming he had meant the cotton on the October *Peerless*. Since the buyer had never communicated to the seller which *Peerless* he meant, a rule like the one in *Murray v. Bethune* presumably would have made the buyer’s testimony irrelevant. But the British court held otherwise. Where the parties had differing interpretations of such an important matter, decided the court, and neither knew of the other’s interpretation, there was simply no contract. The buyer was not liable to take the goods. The *Peerless* case was cited with approval by many treatise writers in Britain and the United States, and it began to make its way into American law.

² [Pothier, of whom you may never have heard, is one of 23 great legal thinkers (from Moses and Hammurabi to Thomas Jefferson and George Mason—whose marble portraits line the chamber of the U.S. House of Representatives. —Eds.)]

As you read the cases below, try to determine whether the outcome is based on what the parties thought (*subjective* agreement), what they said and did (*objective* agreement), or both.

Cases and Materials

STONG v. LANE

Supreme Court of Minnesota
66 Minn. 94, 68 N.W. 765 (1896)

MITCHELL, J.

While the amount in controversy is small, the principle involved is important. The facts are practically undisputed.

The plaintiff being desirous of purchasing a lot as a site for a dwelling, a mutual acquaintance of the parties pointed out to plaintiff a lot which he said defendant had for sale. The lot thus pointed out fronted east on Third Avenue south, being the second lot north from Franklin Avenue, in Minneapolis. The party was mistaken. The lot which defendant had for sale (as agent for the owner) was the one directly opposite on the other side of Third Avenue, being the side "Judge Jones' house is on." This lot fronted west. It was also the second lot north from Franklin Avenue, but, as already stated, on the opposite side of Third Avenue from the one pointed out to plaintiff. Thereupon plaintiff went to see defendant. The precise words by which he opened negotiations do not clearly appear, but their substance was that plaintiff either asked defendant if he had for sale a lot on Third Avenue south, or stated that a lot had been pointed out to him by this mutual acquaintance as one that defendant had for sale, and inquired the price. The evidence is undisputed that defendant told plaintiff that he had for sale the lot on Third Avenue south, being the second lot north of Franklin Avenue, and "on the same side of the street that Judge Jones' house was on." Nothing was said as to whether the lot fronted east or west. It is undisputed that Judge Jones' house is on the east side of Third Avenue, and hence that a lot on that side would front west.

Without defendant's giving any further or more definite description of the lot, and without plaintiff making any further inquiry as to its description and location, the plaintiff proceeded to negotiate as to price. The result was a verbal bargain of sale and purchase for \$2,500, of which plaintiff paid down \$100, the balance to be paid when the title was ascertained to be satisfactory, and upon defendant's procuring the proper deed. Very soon afterwards, plaintiff discovered that the lot described in it was not the lot which had been pointed out to him, and which he supposed he was buying. He then informed the defendant of his mistake, and demanded back his \$100, which

defendant refused to pay, but tendered a deed which plaintiff refused to accept, and then brought this action to recover back the \$100.

The evidence is undisputed that plaintiff was laboring under an honest mistake, and supposed he was buying the lot which had been pointed out to him. It is also undisputed that defendant was equally honest in supposing he was selling the lot on the other side of the street, and that he had no notice of plaintiff's mistake. It will be observed that the description of the two lots was the same, except the reference to the "side of the street that Judge Jones' house was on," which was applicable to the lot defendant had for sale, but inapplicable to the one which plaintiff supposed he was buying. It is familiar law that an honest mistake of one of the parties may be good ground for refusing specific performance, and leaving the other party to his action for damages, while it would be no ground for a rescission of the contract. But the question here is whether, upon the facts, plaintiff is entitled to a rescission, for that is, in effect, what he is asking for in seeking to recover the \$ 100.

Undoubtedly, in order to create a contract, the minds of the parties must meet and agree upon the expressed terms of the contract. Thus, in *Rupley v. Daggett*, 74 Ill. 351, one party offered to sell a horse for \$165; the other party understood him to say \$65. It was held that there was no contract. To the same head may be referred cases where a person, by mistake, enters into a different kind of agreement from that which he intended to make or supposed he was making; as where he signed a bond supposing it to be a mere petition, or which he supposed he was signing merely as a witness. To the same general principle may be referred those cases where, after the parties have apparently agreed to the terms of a contract, it is made to appear that there was a latent ambiguity in an essential word, by which one of the parties meant one thing, and the other a different thing, the essential word being applicable to both. See *Raffles v. Wichelhaus*, 159 Eng. Rep. 375 (Exch. 1864); ³ *Kyle v. Kavanagh*, 103 Mass. 356 (1869).

Had the parties, in their contract, deliberately agreed on a formal description of its subject-matter, the mere fact that plaintiff was mistaken as to the lot to which that description applied, and had in mind another lot of a different description, would be no ground for a rescission. But in this case, while the description given by the defendant was probably sufficient in law to identify the property, it was an unusual and exceedingly informal one, and one very liable to be misunderstood. It was in one sense incomplete, for on its face it did not appear on which side of the street Judge Jones' house was, which was the only thing contained in the description to distinguish the one lot from the other. The other elements of the description being common to both lots, and the plaintiff naturally assuming that the lot referred to was the one

³ [Wait a minute, isn't *Raffles v. Wichelhaus* the influential old English case that we mentioned in the introduction to this unit? It is! Might there be some coherent purpose or plan for what we want you to learn here? Could be! You might want to be on the lookout for logical "threads" like this one throughout this casebook.—Eds.]

that had been pointed out to him, the reference to Judge Jones' house was not calculated to make any particular impression on his mind, as being a material part of the description. Again, the description given by the defendant was never expressly agreed to by the plaintiff. So far as it could be said to have been assented to at all, it was so only impliedly, by plaintiff's proceeding to negotiate as to price, which he evidently did supposing that the lot to which defendant alluded was the one which had been pointed out to him on the ground. Therefore, under the particular facts of this case, it may be fairly said that the minds of the parties never really met or agreed on the words or the terms of the contract, and hence that there never was any binding agreement.

Order affirmed.

Review Question 1. Is the decision in *Stong v. Lane* based on an objective lack of agreement, and subjective lack of agreement, or both? Are you sure that you understand the difference?

Review Question 2. The court uses the phrase "latent ambiguity" in to describe the situation where two parties have different understandings about a contract term. What exactly is the ambiguity in this case, and why is it "latent"? What kind of ambiguity is not "latent"?

OSWALD v. ALLEN

United States Court of Appeals for the Second Circuit
417 F.2d 43 (2d Cir. 1969)

MOORE, Circuit Judge:

Dr. Oswald, a coin collector from Switzerland, was interested in Mrs. Allen's collection of Swiss coins. In April of 1964 Dr. Oswald was in the United States and arranged to see Mrs. Allen's coins. The parties drove to the Newburgh Savings Bank of Newburgh, New York, where two of her collections referred to as the Swiss Coin Collection and the Rarity Coin Collection were located in separate vault boxes. "After examining and taking notes on the coins in the Swiss Coin Collection, Dr. Oswald was shown several valuable Swiss coins from the Rarity Coin Collection. He also took notes on these coins and later testified that he did not know that they were in a separate "collection." The evidence showed that each collection had a different key number and was housed in labeled cigar boxes.

On the return to New York City, Dr. Oswald sat in the front seat of the car while Mrs. Allen sat in the back with Dr. Oswald's brother, Mr. Victor Oswald, and

Mr. Cantarella of the Chase Manhattan Bank's Money Museum, who had helped arrange the meeting and served as Dr. Oswald's agent. Dr. Oswald could speak practically no English and so depended on his brother to conduct the transaction. After some negotiation a price of \$50,000 was agreed upon. Apparently the parties never realized that the references to "Swiss coins" and the "Swiss Coin Collection" were ambiguous. The trial judge found that Dr. Oswald thought the offer he had authorized his brother to make was for all of the Swiss coins, while Mrs. Allen thought she was selling only the Swiss Coin Collection and not the Swiss coins in the Rarity Coin Collection.

On April 8, 1964, Dr. Oswald wrote to Mrs. Allen to "confirm my purchase of all your Swiss coins (gold, silver and copper) at the price of \$50,000." The letter mentioned delivery arrangements through Mr. Cantarella. In response Mrs. Allen wrote on April 15, 1964, that "Mr. Cantarella and I have arranged to go to Newburgh Friday, April 24." This letter does not otherwise mention the alleged contract of sale or the quantity of coins sold. On April 20, realizing that her original estimation of the number of coins in the Swiss Coin Collection was erroneous, Mrs. Allen offered to permit a reexamination and to undertake not to sell to anyone else. Dr. Oswald cabled from Switzerland to Mr. Alfred Barth of the Chase Manhattan Bank, giving instruction to proceed with the transaction. Upon receiving the cable, Barth wrote a letter to Mrs. Allen stating Dr. Oswald's understanding of the agreement and requesting her signature on a copy of the letter as a "mere formality." Mrs. Allen did not sign and return this letter. On April 24, Mrs. Allen's husband told Barth that his wife did not wish to proceed with the sale because her children did not wish her to do so.

Appellant attacks the conclusion of the Court below that a contract did not exist since the minds of the parties had not met. The opinion below states:

Plaintiff believed that he had offered to buy all Swiss coins owned by the defendant while defendant reasonably understood the offer which she accepted to relate to those of her Swiss coins as had been segregated in the particular collection denominated by her as the "Swiss Coin Collection."

285 F. Supp. 488, 492 (S.D.N.Y. 1968). The trial judge based his decision upon his evaluation of the credibility of the witnesses, the records of the defendant, the values of the coins involved, the circumstances of the transaction and the reasonable probabilities. Such findings of fact are not to be set aside unless "clearly erroneous." Fed. R. Civ. P. 52(a). There was ample evidence upon which the trial judge could rely in reaching this decision.

In such a factual situation the law is settled that no contract exists. The Restatement of Contracts in section 71(a) adopts the rule of *Raffles v. Wichelhaus*,⁴ 159 Eng. Rep. 375 (Ex. 1864). Professor Young states that rule as follows:

When any of the terms used to express an agreement is ambivalent, and the parties understand it in different ways, there cannot be a contract unless one of them should have been aware of the other's understanding.

William Young, *Equivocation in Agreements*, 64 COLUM. L. REV. 619, 621 (1964). Even though the mental assent of the parties is not requisite for the formation of a contract (see Comment to Restatement of Contracts § 71 (1932)), the facts found by the trial judge clearly place this case within the small group of exceptional cases in which there is “no sensible basis for choosing between conflicting understandings.” Young, *supra*, 64 COLUM. L. REV. at 647. The rule of *Raffles v. Wichelhaus* is applicable here.

Affirmed.

Review Question 3. *Oswald* refers to section 71 of the original (sometimes later called “First”) Restatement of Contracts. The Restatement (Second) of Contracts phrases things a little differently in its section 20. Review that provision. Assume that it governs the facts in both *Stong* and *Oswald*. How would you analyze these cases under section 20? What results would you get from each case and why? You may also wish to consult sections 18 and 19 while considering these questions.

LUCY v. ZEHMER
Supreme Court of Virginia
196 Va. 493; 84 S.E.2d 516 (1954)

BUCHANAN, J., delivered the opinion of the court.

This suit was instituted by W.O. Lucy and J.C. Lucy, complainants, against A.H. Zehmer and Ida S. Zehmer, his wife, defendants, to have specific performance of a contract by which it was alleged the Zehmers had sold to W.O. Lucy a tract of land owned by A.H. Zehmer in Dinwiddie county containing 471.6 acres, more or less, known as the Ferguson farm, for \$50,000. J.C. Lucy, the other complainant, is a

⁴ [Look, it's that case about the two ships named *Peerless*, again. We were not lying when we called it influential. This unit really does have a pattern to it that you can figure out if you pay attention. By the way, don't think we're always going to be this helpful in pointing out this sort of stuff to you. Learning to figure these things out for themselves is one of the reasons good lawyers are successful, so make the most of your chances to practice.—Eds.]

brother of W.O. Lucy, to whom W.O. Lucy transferred a half interest in his alleged purchase.

The instrument sought to be enforced was written by A.H. Zehmer on December 20, 1952, in these words: "We hereby agree to sell to W.O. Lucy the Ferguson Farm complete for \$50,000.00, title satisfactory to buyer," and signed by the defendants, A.H. Zehmer and Ida S. Zehmer.

The answer of A.H. Zehmer admitted that at the time mentioned W.O. Lucy offered him \$50,000 cash for the farm, but that he, Zehmer, considered that the offer was made in jest; that so thinking, and both he and Lucy having had several drinks, he wrote out "the memorandum" quoted above and induced his wife to sign it; that he did not deliver the memorandum to Lucy, but that Lucy picked it up, read it, put it in his pocket, attempted to offer Zehmer \$5 to bind the bargain, which Zehmer refused to accept, and realizing for the first time that Lucy was serious, Zehmer assured him that he had no intention of selling the farm and that the whole matter was a joke. Lucy left the premises insisting that he had purchased the farm.

Depositions were taken and the decree appealed from was entered holding that the complainants had failed to establish their right to specific performance, and dismissing their bill. The assignment of error is to this action of the court.

W.O. Lucy, a lumberman and farmer, thus testified in substance: He had known Zehmer for fifteen or twenty years and had been familiar with the Ferguson farm for ten years. Seven or eight years ago he had offered Zehmer \$20,000 for the farm which Zehmer had accepted, but the agreement was verbal and Zehmer backed out. On the night of December 20, 1952, around eight o'clock, he took an employee to McKenney, where Zehmer lived and operated a restaurant, filling station and motor court. While there he decided to see Zehmer and again try to buy the Ferguson farm. He entered the restaurant and talked to Mrs. Zehmer until Zehmer came in. He asked Zehmer if he had sold the Ferguson farm. Zehmer replied that he had not. Lucy said, "I bet you wouldn't take \$50,000 for that place." Zehmer replied, "Yes, I would too; you wouldn't give fifty." Lucy said he would and told Zehmer to write up an agreement to that effect. Zehmer took a restaurant check and wrote on the back of it, "I do hereby agree to sell to W.O. Lucy the Ferguson Farm for \$50,000 complete." Lucy told him he had better change it to "We" because Mrs. Zehmer would have to sign it too. Zehmer then tore up what he had written, wrote the agreement quoted above and asked Mrs. Zehmer, who was at the other end of the counter ten or twelve feet away, to sign it. Mrs. Zehmer said she would for \$50,000 and signed it. Zehmer brought it back and gave it to Lucy, who offered him \$5 which Zehmer refused, saying, "You don't need to give me any money, you got the agreement there signed by both of us."

The discussion leading to the signing of the agreement, said Lucy, lasted thirty or forty minutes, during which Zehmer seemed to doubt that Lucy could raise \$50,000. Lucy suggested the provision for having the title examined and Zehmer

made the suggestion that he would sell it “complete, everything there,” and stated that all he had on the farm was three heifers.

Lucy took a partly filled bottle of whiskey into the restaurant with him for the purpose of giving Zehmer a drink if he wanted it. Zehmer did, and he and Lucy had one or two drinks together. Lucy said that while he felt the drinks he took he was not intoxicated, and from the way Zehmer handled the transaction he did not think he was either.

December 20 was on Saturday. Next day Lucy telephoned to J.C. Lucy and arranged with the latter to take a half interest in the purchase and pay half of the consideration. On Monday he engaged an attorney to examine the title. The attorney reported favorably on December 31 and on January 2 Lucy wrote Zehmer stating that the title was satisfactory, that he was ready to pay the purchase price in cash and asking when Zehmer would be ready to close the deal. Zehmer replied by letter, mailed on January 13, asserting that he had never agreed or intended to sell.

Mr. and Mrs. Zehmer were called by the complainants as adverse witnesses. Zehmer testified in substance as follows:

He bought this farm more than ten years ago for \$11,000. He had had twenty-five offers, more or less, to buy it, including several from Lucy, who had never offered any specific sum of money. He had given them all the same answer, that he was not interested in selling it. On this Saturday night before Christmas it looked like everybody and his brother came by there to have a drink. He took a good many drinks during the afternoon and had a pint of his own. When he entered the restaurant around eight-thirty Lucy was there and he could see that he was “pretty high.” He said to Lucy, “Boy, you got some good liquor, drinking, ain’t you?” Lucy then offered him a drink. “I was already high as a Georgia pine, and didn’t have any more better sense than to pour another great big slug out and gulp it down, and he took one too.”

After they had talked a while Lucy asked whether he still had the Ferguson farm. He replied that he had not sold it and Lucy said, “I bet you wouldn’t take \$50,000.00 for it.” Zehmer asked him if he would give \$50,000 and Lucy said yes. Zehmer replied, “You haven’t got \$50,000 in cash.” Lucy said he did and Zehmer replied that he did not believe it. They argued “pro and con for a long time,” mainly about “whether he had \$50,000 in cash that he could put up right then and buy that farm.” Finally, said Zehmer, Lucy told him if he didn’t believe he had \$50,000, “you sign that piece of paper here and say you will take \$50,000.00 for the farm.” He, Zehmer, “just grabbed the back off of a guest check there” and wrote on the back of it. At that point in his testimony Zehmer asked to see what he had written to “see if I recognize my own handwriting.” He examined the paper and exclaimed, “Great balls of fire, I got ‘Firgerson’ for Ferguson. I have got satisfactory spelled wrong. I don’t recognize that writing if I would see it, wouldn’t know it was mine.”

After Zehmer had, as he described it, “scribbled this thing off,” Lucy said, “Get your wife to sign it.” Zehmer walked over to where she was and she at first refused to sign but did so after he told her that he “was just needling him [Lucy], and didn’t mean a thing in the world, that I was not selling the farm.” Zehmer then “took it back over there and I was still looking at the dern thing. I had the drink right there by my hand, and I reached over to get a drink, and he said, ‘Let me see it.’ He reached and picked it up, and when I looked back again he had it in his pocket and he dropped a five dollar bill over there, and he said, ‘Here is five dollars payment on it.’ I said, ‘Hell no, that is beer and liquor talking. I am not going to sell you the farm. I have told you that too many times before.’”

Mrs. Zehmer testified that when Lucy came into the restaurant he looked as if he had had a drink. When Zehmer came in he took a drink out of a bottle that Lucy handed him. She went back to help the waitress who was getting things ready for next day. Lucy and Zehmer were talking but she did not pay too much attention to what they were saying. She heard Lucy ask Zehmer if he had sold the Ferguson farm, and Zehmer replied that he had not and did not want to sell it. Lucy said, “I bet you wouldn’t take \$50,000 cash for that farm,” and Zehmer replied, “You haven’t got \$50,000 cash.” Lucy said, “I can get it.” Zehmer said he might form a company and get it, “but you haven’t got \$50,000.00 cash to pay me tonight.” Lucy asked him if he would put it in writing that he would sell him this farm. Zehmer then wrote on the back of a pad, “I agree to sell the Ferguson Place to W.O. Lucy for \$50,000.00 cash.” Lucy said, “All right, get your wife to sign it.” Zehmer came back to where she was standing and said, “You want to put your name to this?” She said “No,” but he said in an undertone, “It is nothing but a joke,” and she signed it.

On examination by her own counsel she said that her husband laid this piece of paper down after it was signed; that Lucy said to let him see it, took it, folded it and put it in his wallet, then said to Zehmer, “Let me give you \$5.00,” but Zehmer said, “No, this is liquor talking. I don’t want to sell the farm, I have told you that I want my son to have it. This is all a joke.” Lucy then said at least twice, “Zehmer, you have sold your farm,” wheeled around and started for the door. He paused at the door and said, “I will bring you \$50,000 tomorrow. * * * No, tomorrow is Sunday. I will bring it to you Monday.” She said you could tell definitely that he was drinking and she said to her husband, “You should have taken him home,” but he said, “Well, I am just about as bad off as he is.”

The defendants insist that the evidence was ample to support their contention that the writing sought to be enforced was prepared as a bluff or dare to force Lucy to admit that he did not have \$50,000; that the whole matter was a joke; that the writing was not delivered to Lucy and no binding contract was ever made between the parties.

It is an unusual, if not bizarre, defense. When made to the writing admittedly prepared by one of the defendants and signed by both, clear evidence is required to sustain it.

In his testimony Zehmer claimed that he “was high as a Georgia pine,” and that the transaction “was just a bunch of two doggoned drunks bluffing to see who could talk the biggest and say the most.” That claim is inconsistent with his attempt to testify in great detail as to what was said and what was done. It is contradicted by other evidence as to the condition of both parties, and rendered of no weight by the testimony of his wife that when Lucy left the restaurant she suggested that Zehmer drive him home. The record is convincing that Zehmer was not intoxicated to the extent of being unable to comprehend the nature and consequences of the instrument he executed, and hence that instrument is not to be invalidated on that ground. 17 C.J.S., *Contracts*, § 133b at 483; *Taliaferro v. Emery*, 98 S.E. 627 (Va. 1919). It was in fact conceded by defendants’ counsel in oral argument that under the evidence Zehmer was not too drunk to make a valid contract.

The evidence is convincing also that Zehmer wrote two agreements, the first one beginning “I hereby agree to sell.” Zehmer first said he could not remember about that, then that “I don’t think I wrote but one out.” Mrs. Zehmer said that what he wrote was “I hereby agree,” but that the “I” was changed to “We” after that night. The agreement that was written and signed is in the record and indicates no such change. Neither are the mistakes in spelling that Zehmer sought to point out readily apparent.

The appearance of the contract, the fact that it was under discussion for forty minutes or more before it was signed; Lucy’s objection to the first draft because it was written in the singular, and he wanted Mrs. Zehmer to sign it also; the rewriting to meet that objection and the signing by Mrs. Zehmer; the discussion of what was to be included in the sale, the provision for the examination of the title, the completeness of the instrument that was executed, the taking possession of it by Lucy with no request or suggestion by either of the defendants that he give it back, are facts which furnish persuasive evidence that the execution of the contract was a serious business transaction rather than a casual, jesting matter as defendants now contend.

On Sunday, the day after the instrument was signed on Saturday night, there was a social gathering in a home in the town of McKenney at which there were general comments that the sale had been made. Mrs. Zehmer testified that on that occasion as she passed by a group of people, including Lucy, who were talking about the transaction, \$50,000 was mentioned, whereupon she stepped up and said, “Well, with the high-price whiskey you were drinking last night you should have paid more. That was cheap.” Lucy testified that at that time Zehmer told him that he did not want to “stick” him or hold him to the agreement because he, Lucy, was too tight and didn’t know what he was doing, to which Lucy replied that he was not too tight; that he had been stuck before and was going through with it. Zehmer’s version was that

he said to Lucy: “I am not trying to claim it wasn’t a deal on account of the fact the price was too low. If I had wanted to sell \$50,000.00 would be a good price, in fact I think you would get stuck at \$50,000.00.” A disinterested witness testified that what Zehmer said to Lucy was that “he was going to let him up off the deal, because he thought he was too tight, didn’t know what he was doing. Lucy said something to the effect that ‘I have been stuck before and I will go through with it.’”

If it be assumed, contrary to what we think the evidence shows, that Zehmer was jesting about selling his farm to Lucy and that the transaction was intended by him to be a joke, nevertheless the evidence shows that Lucy did not so understand it but considered it to be a serious business transaction and the contract to be binding on the Zehmers as well as on himself. The very next day he arranged with his brother to put up half the money and take a half interest in the land. The day after that he employed an attorney to examine the title. The next night, Tuesday, he was back at Zehmer’s place and there Zehmer told him for the first time, Lucy said, that he wasn’t going to sell and he told Zehmer, “You know you sold that place fair and square.” After receiving the report from his attorney that the title was good he wrote to Zehmer that he was ready to close the deal.

Not only did Lucy actually believe, but the evidence shows he was warranted in believing, that the contract represented a serious business transaction and a good faith sale and purchase of the farm.

In the field of contracts, as generally elsewhere, “We must look to the outward expression of a person as manifesting his intention rather than to his secret and unexpressed intention. ‘The law imputes to a person an intention corresponding to the reasonable meaning of his words and acts.’” *First National Exchange Bank v. Roanoke Oil Co.*, 192 S.E. 764, 770 (Va. 1934).

At no time prior to the execution of the contract had Zehmer indicated to Lucy by word or act that he was not in earnest about selling the farm. They had argued about it and discussed its terms, as Zehmer admitted, for a long time. Lucy testified that if there was any jesting it was about paying \$50,000 that night. The contract and the evidence show that he was not expected to pay the money that night. Zehmer said that after the writing was signed he laid it down on the counter in front of Lucy. Lucy said Zehmer handed it to him. In any event there had been what appeared to be a good faith offer and a good faith acceptance, followed by the execution and apparent delivery of a written contract. Both said that Lucy put the writing in his pocket and then offered Zehmer \$5 to seal the bargain. Not until then, even under the defendants’ evidence, was anything said or done to indicate that the matter was a joke. Both of the Zehmers testified that when Zehmer asked his wife to sign he whispered that it was a joke so Lucy wouldn’t hear and that it was not intended that he should hear.

The mental assent of the parties is not requisite for the formation of a contract. If the words or other acts of one of the parties have but one reasonable meaning, his undisclosed intention is immaterial except when an unreasonable meaning which he

attaches to his manifestations is known to the other party. Restatement of the Law of Contracts § 71 (1932). The law, therefore, judges of an agreement between two persons exclusively from those expressions of their intentions which are communicated between them. WILLIAM L. CLARK, *LAW OF CONTRACTS* § 3 at 4 (1931).

An agreement or mutual assent is of course essential to a valid contract but the law imputes to a person an intention corresponding to the reasonable meaning of his words and acts. If his words and acts, judged by a reasonable standard, manifest an intention to agree, it is immaterial what may be the real but unexpressed state of his mind. 17 C.J.S., *Contracts* § 32 at 361; 12 AM. JUR., *Contracts* § 19 at 515. So a person cannot set up that he was merely jesting when his conduct and words would warrant a reasonable person in believing that he intended a real agreement.

Whether the writing signed by the defendants and now sought to be enforced by the complainants was the result of a serious offer by Lucy and a serious acceptance by the defendants, or was a serious offer by Lucy and an acceptance in secret jest by the defendants, in either event it constituted a binding contract of sale between the parties.

The complainants are entitled to have specific performance of the contracts sued on. The decree appealed from is therefore reversed and the cause is remanded for the entry of a proper decree requiring the defendants to perform the contract in accordance with the prayer of the bill.

Reversed and remanded.

Review Question 4. In both *Stong* and *Oswald*, the parties did not understand their respective proposed deals in the same way. What, if anything, is different about the situation in *Lucy v. Zehmer* that leads to a different result?

AUGSTEIN v. LESLIE

United States District Court for the Southern District of New York
11 Civ. 7512 (HB), 2012 U.S. Dist. LEXIS 149517 (S.D.N.Y. Oct. 17, 2012)

HAROLD BAER, JR., U.S.D.J.

Armin Augstein brought this action to collect a reward from Ryan Leslie upon the return of Leslie's stolen laptop computer. The laptop was stolen and recovered in Germany and returned to Leslie in New York.

Leslie is a musician. While on tour in Germany, Leslie's laptop computer, external hard drive, and certain other belongings were stolen. The laptop contained

valuable intellectual property, including music and videos related to Leslie’s records and performances. In videos, news articles, and online postings, Leslie stated that he would pay \$20,000—later increased to \$1 million—to anyone who returned his property. After Augstein returned the laptop and hard drive, Leslie refused to pay the reward because, Leslie alleges, the intellectual property for which he valued the laptop was not present on the hard drive when it was returned. Leslie claims that he and several staff members tried to access the data on the hard drive but were unable to do so. Leslie sent the hard drive to the manufacturer, Avastor, which ultimately deleted the information prior to sending Leslie a replacement. Augstein now argues the Court should grant him summary judgment on the issues of the validity of the offer and of the reward and its subsequent acceptance and performance by Augstein when he returned the laptop to the police in Germany.

Augstein argues that Leslie made an offer of a reward for the return of his property and that Augstein accepted and fully performed when he presented the property to the police in Germany. Leslie responds that a reasonable person would not have understood the mention of the reward to be an offer of a unilateral contract, but instead would have understood it to be an advertisement—in essence, an invitation to negotiate. And even if it was an offer, Leslie continues, Augstein did not perform because he did not return the intellectual property, only the physical property. Whether or not the external hard drive, which was subsequently destroyed by Avastor, contained Leslie’s intellectual property is a heavily disputed issue in this case.

A district court may not grant summary judgment if there exists a genuine issue of material fact. For summary judgment purposes, a genuine issue exists where the evidence is such that a reasonable jury could decide in the non-moving party’s favor. “An offer is the manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to that bargain is invited and will conclude it.” Restatement (Second) of Contracts § 24 (1981). To evaluate the legitimacy of this offer, the court should consider “what an objective, reasonable person would have understood [Leslie’s conduct] to convey.” *Leonard v. PepsiCo, Inc.*, 88 F. Supp. 2d 116, 127 (S.D.N.Y. 1999).

Leslie mentioned the \$20,000 reward for the return of his property in a YouTube video on October 24, 2010. In the video, Leslie says, “I am offering a reward of \$20,000.” See also “Ryan Leslie Gets His Laptop Stolen in Germany! Offering \$20,000 Reward,” YouTube (Oct. 26, 2010):

[\[https://www.youtube.com/watch?v=YvVPjZ-wvkE\]](https://www.youtube.com/watch?v=YvVPjZ-wvkE).

He also implied that the lost property was worth much more than \$20,000. On November 6, 2010, a video was posted increasing the reward to \$1,000,000. At the end of the video, a message reads, “In the interest of retrieving the invaluable intellectual property contained on his laptop & hard drive, Mr. Leslie has increased

the reward offer from \$20,000 to \$1,000,000 USD.” RyanLeslieTV, “Ryan Leslie—European Tour and Reward Announcement,” YouTube (Nov. 6, 2010):

[\[https://www.youtube.com/watch?v=F8Jf0huEyNU\]](https://www.youtube.com/watch?v=F8Jf0huEyNU).

The increase of the reward was publicized on Leslie’s Facebook and Twitter accounts, including a post on Twitter which read, “I’m absolutely continuing my Euro tour + I raised the reward for my intellectual property to \$1mm” and included a link to the video on YouTube. News organizations also published reports on Leslie’s reward offer, both in print and online. Finally, Leslie was interviewed on MTV on November 11, 2010, and reiterated the \$1,000,000 reward, saying “I got a million dollar reward for anybody that can return all my intellectual property to me.”

Leslie’s videos and other activities together are best characterized as an offer for a reward. Leslie “sought to induce performance, unlike an invitation to negotiate [often an advertisement], which seeks a reciprocal promise.” *Leonard*, 88 F. Supp. 2d at 125 (discussing *Carlill v. Carbolic Smoke Ball Co.*, [1892] 1 Q.B. 256 (Eng.)). Offers of reward are “intended to induce a potential offeree to perform a specific action.” *Id.* at 126. A reasonable person viewing the video would understand that Leslie was seeking the return of his property and that by returning it, the bargain would be concluded. The increase of the reward from \$20,000 to \$1,000,000, the value of the property lost (in particular the unreleased album) and the news reports regarding the reward offer would lead a reasonable person to believe that Leslie was making an offer. As such, the video constitutes a valid offer and summary judgment is granted as to that issue. “[I]f a person chooses to make extravagant promises . . . he probably does so because it pays him to make them, and, if he has made them, the extravagance of the promises is no reason in law why he should not be bound by them.” *Id.* at 125 (quoting *Carbolic Smoke Ball*, 1 Q.B. at 268 (Bowen, L.J.)).

Leslie attempts to persuade the court that the video is not an offer but an advertisement. Because advertisements, Leslie argues, are not generally considered offers, there is no contract. He cites *Leonard v. PepsiCo*, where the court did find an advertisement rather than an offer, to support that argument.¹ However, unlike the television commercial in *Leonard*, Leslie’s conduct in this case was meant to induce performance. Leslie was not seeking a promise from an individual who would return his belongings, rather he was seeking performance—the actual return of his property. In addition, his videos and other commentary cannot be reasonably understood as an invitation to negotiate because, similarly, Leslie was not soliciting help in finding his property, but the actual return itself. Leslie also relies on the fact that the offer was conveyed over YouTube (a website where many advertisements and promotional videos are shared, along with any number of other types of video) to undermine the legitimacy of the offer. I do not find this reasoning persuasive. The forum for conveying the offer is not determinative, but rather, the question is whether a

¹ [Take note of this *Leonard* case, as you will be reading it quite soon. – Eds.]

reasonable person would have understood that Leslie made an offer of a reward. I conclude that they would.

Augstein's motion for summary judgment is GRANTED insofar as he seeks a declaration that the reward was an offer.

Review Question 5. The *Augstein* court uses the term “unilateral contract.” What does that mean and how does it differ from a “bilateral contract”? Look up both terms and make sure you would be able to explain their meanings to a classmate or your professor. You will come across one or both of these terms in many contracts cases, so you might as well know what the courts are talking about.

Review Question 6. The first three cases in this unit (*Stong*, *Oswald*, and *Lucy*) all involve situations in which the parties seem to have reached at least some kind of agreement about something. Is that the issue in *Augstein*? Did the parties argue that they were mistaken about what they agreed to, or that they never agreed at all?

Problems

Problem 3.1

Tyson is a major American producer of fresh frozen chicken. Männliches Huhn GmbH (MHG) is a German supplier of chicken to restaurants and fast-food establishments in Europe. After some telephone discussions between Tyson's offices in Little Rock and MHG's offices in Frankfurt, MHG orally agrees to buy 100,000 lbs. of fresh frozen chicken from Tyson, to be packed in cryovac and delivered to MHG in Germany. Tyson sends a memorandum of the offer to MHG as an invoice describing the product as “US Fresh Frozen Chicken, Grade A, Government Inspected, Eviscerated, each chicken individually wrapped in Cryovac, packed suitable for export.” When the chicken arrived at MHG, however, the company rejected it, saying that the chickens delivered were cheap “stewing chickens”—that is, chickens suitable only for things like soup and pot pies—rather than more expensive “frying” chickens which are suitable for cooking and barbecuing in restaurants. The chicken as delivered was useless to MHG. Tyson sued, claiming that it had a contract to deliver “chicken,” and that the birds delivered were, in fact, “chickens.”

Is there a contract between the parties? If so, is it for stewing chickens or frying chickens? Based on what you have learned in this unit, what would you expect the arguments for both sides to be?

Problem 3.2

Jay the owner of an automobile body shop, has a 1962 Chevrolet Corvette convertible, all original and beautifully restored. His neighbor, Zeke, a very well-to-do investment banker, has long coveted the car and over the years has repeatedly asked Jay if he would sell. Jay has always refused. In early March Jay learns that his wife, Vera, has been having an affair with Zeke. Jay does not want a divorce, but he wants revenge. Jay purchases a rather beat-up 1994 Corvette for \$3,500. Pretending that he is ignorant of the affair, Jay has a conversation with Zeke.

“You know, Zeke,” he says, “I’m really torn about the Corvette.”

“What about it?” says Zeke.

“Well,” says Jay, “business has been off at the shop with this recession, and a lot of my investments are down. You know, the economy and everything.”

“Of course,” says Zeke. “Things are tough.”

“They sure are. Fact is, though, much as I don’t want to, I’ve got a Corvette I don’t need, and some ready cash would be very helpful.”

“You mean, you want to sell your Corvette?”

“I don’t really want to. But you know how it is.”

“Sure,” says Zeke, who really doesn’t, since his investment bank paid him a hefty bonus this year. But he says, “How much are you asking?”

Jay hesitates. “I hadn’t really decided on it.”

“Well, if it will help you out I’ll give you \$65,000 for it, right now,” says Zeke.

Jay shakes his head. “Thanks. I appreciate that. But I’m not sure I really want to sell. The cash is tempting, but” He breaks off.

“But what?”

“I want to think it over. It’s a tough decision.”

“Tell you what,” says Zeke. “I’ll give you \$70,000 right now.” He pulls out a checkbook. “Right now,” he repeats. “That’s a very good offer, you know.”

“I know.” Jay hesitates again. “Actually, I feel like I’m taking advantage of you at that price.”

Zeke waves a hand. “Don’t worry about me. I can afford it. The investment banking business is still going strong.” He grins and takes out a pen. “I can write the check right now. It’s good. You can get the cash tomorrow morning.”

Jay agrees. Zeke writes the check. Jay insists on filling out a bill of sale, specifying the price and a Vehicle Identification Number of 299492033218. He tells

Zeke that the Corvette (and the title document) is down at Jay's shop, getting a new wax polishing, and that Zeke can pick it up tomorrow.

The next day Zeke goes to Jay's shop and is handed the keys and the signed title to the freshly polished but still rather battered 1994 Corvette. He is furious. He charges into Jay's office, but Jay just laughs at him. Jay had cashed the check first thing in the morning and has already pocketed the proceeds. Zeke threatens all sorts of dire things.

"You bought a *Corvette*," says Jay. He picks up the bill of sale. "You got a *Corvette*. It's VIN 299492033218, exactly what it says on the bill of sale and on the car title you're holding there. It's not my problem if you don't look at what you sign." Jay grins happily. "I think maybe you paid a little too much for it," he says, "But as you said, you can afford it. I'm sure Vera is worth it. Have a really *nice* day, Zeke."

Zeke subsequently sues Jay, demanding the 1962 Corvette or a refund of his money. Is there a contract between the parties? If so, is it for the 1962 Corvette or the 1994 Corvette? Be prepared to make arguments on behalf of both Zeke and Jay when considering this problem.

Problem 3.3

Walker is the owner of Rose, a registered purebred polled Angus descended from a long line of highly regarded stock. He buys her for breeding purposes, for which purpose she is worth about \$10,000. After a few years and various veterinary examinations, Walker determines that Rose is infertile. Accordingly, he sells Rose, whom he believes is barren, to Sherwood for \$500—essentially her value as meat. They sign a contract that Walker will deliver Rose this coming Thursday. On the morning set for delivery, Walker discovers that Rose is, in fact, with calf. He refuses to deliver her, claiming that neither party intended this to be a transaction for a breeding cow. Sherwood demands Rose.

When Walker continues to refuse, Sherwood sues. Did the parties have a contract or not? What would you expect the two sides to argue regarding that issue?

Unit 4: Offers to Contract

CONTRACT FORMATION

Part Two

FOCUS OF THIS UNIT

Formation in Steps or All at Once? How are contracts formed? Historically, most of them tended to be made in one of three ways: a face-to-face agreement followed by a handshake, a meeting at which a contract document that had been prepared in advance was signed by the parties, or an exchange of correspondence through physical mail—“snail mail” as many of you might know it—or (later) telegrams.

In the handshake and contemporaneous-signature situations, the questions of who first proposed the exchange and who said what during the discussion are largely irrelevant. The important facts are the substance of the final terms agreed to by the parties. Using modern terminology, we can think of these as “synchronous” transactions, because the creation of the agreement takes place in real time with the contracting parties having a largely simultaneous experience.

The Place of Offer and Acceptance. In the third situation, however, where the parties are sending communications back and forth in an “asynchronous” transaction, a potential problem arises. Suppose *A* sent a letter proposing to sell Blackacre to *B* for \$500,000, and *B* sent a letter in response. We have to put the two together and see if there is an agreement. In this case we would ask whether *A* made an *offer* in his letter, and whether *B*'s letter in return *accepted* the offer. To answer that question we would have to define what an “offer” and an “acceptance” are for purposes of contract law. If *A*'s letter is not an “offer” in the legal sense, then there is no contract no matter what *B* wrote. If *A*'s letter *is* an offer, but *B*'s response is not an “acceptance” in the legal sense, there is (again) no contract. In this kind of asynchronous transaction we need, legally speaking, an offer *and* an acceptance. In this analysis, *A* (the person making the offer) is called the *offeror*, and *B* (the recipient of the offer) is the *offeree*.

In the modern world, the question of who made the offer and who made the acceptance is often irrelevant because the existence of mutual assent is so clear. When you carry the goods to the checkout counter, or click the “buy” button on a web site, or buy a burger at a fast-food window, or haggle with your friend about buying

her car, the question of whether you are the offeror or offeree in such transactions makes little difference. Yet while issues of offer-and-acceptance are relatively unimportant in some transactions, they are critical in others—especially in a world in which parties deal with each other at great distances. You need think back only to *Augsberg v. Leslie*, in the last unit, to recall the argument that Ryan Leslie’s internet pleas were not offers.

Asynchronous Contracts. The issue of contracts entered into by exchanges of communications at a distance is a comparatively new thing in the many centuries of the common law. Until there were reliable means of exchanging communications (the post and the telegraph) and recipients who could actually read, contracts were rarely formed at a distance. In the rapidly industrializing 19th century, however, such contracts began appearing with some frequency. One obvious question was how the minds of two parties can meet if they are not acting at the same time. As commerce in England was more advanced than that in the young United States, English courts often dealt with these issues before their American counterparts, and their decisions had a substantial impact.

Another important point addressed in *Augsberg v. Leslie* is the idea that a public offer of a reward is (in the legal sense) an offer—as Mr. Leslie discovered. This rule was settled in important English cases like *Williams v Carwardine*, 10 E.R. 590 (K.B. 1833). That the mere fact that the reward seems extravagant does not necessarily let the offeror off the hook, as another English court held in *Carlill v. Carbolic Smoke Ball Co.*, 1 Q.B. 256 (C.A. 1892), which also held that a newspaper advertisement could be an offer. “If a person chooses to make extravagant promises,” wrote Lord Justice Bowen, “he probably does so because it pays him to make them, and, if he has made them, the extravagance of the promises is no reason in law why he should not be bound by them.” You will meet *Carbolic Smoke Ball* again in the cases below.¹

Offer Inviting Acceptance. We now start with the idea of the “offer.” What kinds of statements qualify as “offers” for purposes of contract law? As you will see, there are no magic words—everything depends on wording of the communication and the context in which it is made. Nevertheless, there are some basic rules and guidelines which the following cases are designed to help you uncover. You may want

¹ [The infamous advertisement—which you can easily find online—stated that a £100 “reward will be paid by the Carbolic Smoke Ball Company to any person who contracts the increasing epidemic influenza, colds, or any disease caused by taking cold, after having used the ball three times daily for two weeks, according to the printed directions supplied with each ball.” 1 Q.B. at 257. Mrs. Louisa Elizabeth Carlill used the vapor-emitting ball in her nose three times daily for about two months before she contracted the flu. Upon Carlill’s demand for £100—equivalent to about \$30,000 as these materials are written—Carbolic refused to pay, claiming, among other things, that the advertisement was not an offer. They lost. – Eds.]

to review sections 22, 24, 26, and 29 of the Restatement (Second) of Contracts in connection with this unit.

If you would like to get an idea of the bigger picture for offer and acceptance, note that the Restatement devotes a whopping 47 sections to specific rules regarding offers (§§ 24-49), and acceptances (§§ 50-70). Spending some time skimming over these sections—do not bother reading them intently quite yet—will give you some context for the issues you are likely to run across in this and the remaining units on contract formation.

Cases and Materials

LEONARD v. PEPSICO, INC.

United States District Court for the Southern District of New York
88 F. Supp. 2d 116 (S.D.N.Y. 1999)

WOOD, U.S.D.J.:

Plaintiff brought this action seeking, among other things, specific performance of an alleged offer of a Harrier Jet, featured in a television advertisement for defendant's "Pepsi Stuff" promotion. Defendant has moved for summary judgment pursuant to Federal Rule of Civil Procedure 56. For the reasons stated below, defendant's motion is granted.

Background

Because whether the television commercial constituted an offer is the central question in this case, the Court will describe the commercial in detail. The commercial opens upon an idyllic, suburban morning, where the chirping of birds in sun-dappled trees welcomes a paperboy on his morning route. As the newspaper hits the stoop of a conventional two-story house, the tattoo of a military drum introduces the subtitle, "MONDAY 7:58 AM." The stirring strains of a martial air mark the appearance of a well-coiffed teenager preparing to leave for school, dressed in a shirt emblazoned with the Pepsi logo, a red-white-and-blue ball. While the teenager confidently preens, the military drumroll again sounds as the subtitle "T-SHIRT 75 PEPSI POINTS" scrolls across the screen. Bursting from his room, the teenager strides down the hallway wearing a leather jacket. The drumroll sounds again, as the subtitle "LEATHER JACKET 1450 PEPSI POINTS" appears. The teenager opens the door of his house and, unfazed by the glare of the early morning sunshine, puts on a pair of sunglasses. The drumroll then accompanies the subtitle "SHADES 175 PEPSI POINTS." A voiceover then intones, "Introducing the new Pepsi Stuff catalog," as the camera focuses on the cover of the catalog.

The scene then shifts to three young boys sitting in front of a high school building. The boy in the middle is intent on his Pepsi Stuff Catalog, while the boys on either side are each drinking Pepsi. The three boys gaze in awe at an object rushing overhead, as the military march builds to a crescendo. The Harrier Jet is not yet visible, but the observer senses the presence of a mighty plane as the extreme winds generated by its flight create a paper maelstrom in a classroom devoted to an otherwise dull physics lesson. Finally, the Harrier Jet swings into view and lands by the side of the school building, next to a bicycle rack. Several students run for cover, and the velocity of the wind strips one hapless faculty member down to his underwear. While the faculty member is being deprived of his dignity, the voiceover announces: “Now the more Pepsi you drink, the more great stuff you’re gonna get.”

The teenager opens the cockpit of the fighter and can be seen, helmetless, holding a Pepsi. “Looking very pleased with himself,” the teenager exclaims, “Sure beats the bus,” and chortles. The military drumroll sounds a final time, as the following words appear: “HARRIER FIGHTER 7,000,000 PEPSI POINTS.” A few seconds later, the following appears in more stylized script: “Drink Pepsi—Get Stuff.” With that message, the music and the commercial end with a triumphant flourish.

Inspired by this commercial, plaintiff set out to obtain a Harrier Jet. Plaintiff explains that he is “typical of the ‘Pepsi Generation’ . . . he is young, has an adventurous spirit, and the notion of obtaining a Harrier Jet appealed to him enormously.” Plaintiff consulted the Pepsi Stuff Catalog. The Catalog features youths dressed in Pepsi Stuff regalia or enjoying Pepsi Stuff accessories, such as “Blue Shades” (“As if you need another reason to look forward to sunny days.”), “Pepsi Tees” (“Live in ’em. Laugh in ’em. Get in ’em.”), “Bag of Balls” (“Three balls. One bag. No rules.”), and “Pepsi Phone Card” (“Call your mom!”). The Catalog specifies the number of Pepsi Points required to obtain promotional merchandise. The Catalog includes an Order Form which lists, on one side, fifty-three items of Pepsi Stuff merchandise redeemable for Pepsi Points. Conspicuously absent from the Order Form is any entry or description of a Harrier Jet. The amount of Pepsi Points required to obtain the listed merchandise ranges from 15 (for a “Jacket Tattoo” (“Sew ’em on your jacket, not your arm.”)) to 3300 (for a “Fila Mountain Bike” (“Rugged. All-terrain. Exclusively for Pepsi.”)). It should be noted that plaintiff objects to the implication that because an item was not shown in the Catalog, it was unavailable.

The rear foldout pages of the Catalog contain directions for redeeming Pepsi Points for merchandise. These directions note that merchandise may be ordered “only” with the original Order Form. The Catalog notes that in the event that a consumer lacks enough Pepsi Points to obtain a desired item, additional Pepsi Points may be purchased for ten cents each; however, at least fifteen original Pepsi Points must accompany each order.

Although plaintiff initially set out to collect 7,000,000 Pepsi Points by consuming Pepsi products, it soon became clear to him that he “would not be able to buy (let alone drink) enough Pepsi to collect the necessary Pepsi Points fast enough.” Reevaluating his strategy, plaintiff “focused for the first time on the packaging materials in the Pepsi Stuff promotion,” and realized that buying Pepsi Points would be a more promising option. Through acquaintances, plaintiff ultimately raised about \$700,000.

On or about March 27, 1996, plaintiff submitted an Order Form, fifteen original Pepsi Points, and a check for \$700,008.50. Plaintiff appears to have been represented by counsel at the time he mailed his check; the check is drawn on an account of plaintiff’s first set of attorneys. At the bottom of the Order Form, plaintiff wrote in “1 Harrier Jet” in the “Item” column and “7,000,000” in the “Total Points” column. In a letter accompanying his submission, plaintiff stated that the check was to purchase additional Pepsi Points “expressly for obtaining a new Harrier jet as advertised in your Pepsi Stuff commercial.”

On or about May 7, 1996, defendant’s fulfillment house rejected plaintiff’s submission and returned the check, explaining that:

The item that you have requested is not part of the Pepsi Stuff collection. It is not included in the catalogue or on the order form, and only catalogue merchandise can be redeemed under this program.

The Harrier jet in the Pepsi commercial is fanciful and is simply included to create a humorous and entertaining ad. We apologize for any misunderstanding or confusion that you may have experienced and are enclosing some free product coupons for your use.

Plaintiff’s previous counsel responded on or about May 14, 1996, as follows:

Your letter of May 7, 1996 is totally unacceptable. We have reviewed the video tape of the Pepsi Stuff commercial and it clearly offers the new Harrier jet for 7,000,000 Pepsi Points. Our client followed your rules explicitly.

This is a formal demand that you honor your commitment and make immediate arrangements to transfer the new Harrier jet to our client. If we do not receive transfer instructions within ten (10) business days of the date of this letter you will leave us no choice but to file an appropriate action against Pepsi.

This letter was apparently sent onward to the advertising company responsible for the actual commercial, BBDO New York. In a letter dated May 30, 1996, BBDO Vice President Raymond E. McGovern, Jr., explained to plaintiff that:

I find it hard to believe that you are of the opinion that the Pepsi Stuff commercial (“Commercial”) really offers a new Harrier Jet. The use of

the Jet was clearly a joke that was meant to make the Commercial more humorous and entertaining. In my opinion, no reasonable person would agree with your analysis of the Commercial.

On or about June 17, 1996, plaintiff mailed a similar demand letter to defendant.

The question of whether or not a contract was formed is appropriate for resolution on summary judgment. As the Second Circuit has recently noted, “Summary judgment is proper when the words and actions that allegedly formed a contract [are] so clear themselves that reasonable people could not differ over their meaning.” *Krumme v. Westpoint Stevens, Inc.*, 143 F.3d 71, 83 (2d Cir. 1998)

*Defendant’s Advertisement
Was Not an Offer*

The general rule is that an advertisement does not constitute an offer. Restatement (Second) of Contracts § 26, comment b, explains that:

Advertisements of goods by display, sign, handbill, newspaper, radio or television are not ordinarily intended or understood as offers to sell. The same is true of catalogues, price lists and circulars, even though the terms of suggested bargains may be stated in some detail. It is of course possible to make an offer by an advertisement directed to the general public (see § 29), but there must ordinarily be some language of commitment or some invitation to take action without further communication.

Similarly, a leading treatise notes that:

It is quite possible to make a definite and operative offer to buy or sell goods by advertisement, in a newspaper, by a handbill, a catalog or circular or on a placard in a store window. It is not customary to do this, however; and the presumption is the other way. . . . Such advertisements are understood to be mere requests to consider and examine and negotiate; and no one can reasonably regard them as otherwise unless the circumstances are exceptional and the words used are very plain and clear.

1 ARTHUR LINTON CORBIN & JOSEPH M. PERILLO, CORBIN ON CONTRACTS § 2.4, at 116-17 (rev. ed. 1993).

In *Mesaros v. United States*, 845 F.2d 1576 (Fed. Cir. 1988), the plaintiffs sued the United States Mint for failure to deliver a number of Statue of Liberty commemorative coins that they had ordered. When demand for the coins proved unexpectedly robust, a number of individuals who had sent in their orders in a timely fashion were left empty-handed. The court began by noting the “well-established” rule that advertisements and order forms are “mere notices and solicitations for offers

which create no power of acceptance in the recipient.” The spurned coin collectors could not maintain a breach of contract action because no contract would be formed until the advertiser accepted the order form and processed payment. Under these principles, plaintiff’s letter of March 27, 1996, with the Order Form and the appropriate number of Pepsi Points, constituted the offer.

The exception to the rule that advertisements do not create any power of acceptance in potential offerees is where the advertisement is “clear, definite, and explicit, and leaves nothing open for negotiation,” in that circumstance, “it constitutes an offer, acceptance of which will complete the contract.” *Lefkowitz v. Great Minneapolis Surplus Store*, 86 N.W.2d 689, 691 (Minn. 1957). In *Lefkowitz*, the court ruled that because plaintiff had fulfilled all of the terms of the advertisement² and the advertisement was specific and left nothing open for negotiation, a contract had been formed.

The present case is distinguishable from *Lefkowitz*. First, the [Pepsi] commercial cannot be regarded in itself as sufficiently definite, because it specifically reserved the details of the offer to a separate writing, the Catalog. Second, even if the Catalog had included a Harrier Jet among the items that could be obtained by redemption of Pepsi Points, the advertisement of a Harrier Jet by both television commercial and catalog would still not constitute an offer. As the *Mesaros* court explained, the absence of any words of limitation such as “first come, first served,” renders the alleged offer sufficiently indefinite that no contract could be formed.

The Court finds, in sum, that the Harrier Jet commercial was merely an advertisement. The Court now turns to the line of cases upon which plaintiff rests much of his argument.

In opposing the present motion, plaintiff largely relies on a different species of unilateral offer, involving public offers of a reward for performance of a specified act. Because these cases generally involve public declarations regarding the efficacy or trustworthiness of specific products, one court has aptly characterized these authorities as “prove me wrong” cases. The most venerable of these precedents is the case of *Carlill v. Carbolic Smoke Ball Co.*, 1 Q.B. 256 (Court of Appeal, 1892), a quote from which heads plaintiff’s memorandum of law.

Other “reward” cases underscore the distinction between typical advertisements, in which the alleged offer is merely an invitation to negotiate for

² [In relevant part, the advertisement published in a Minneapolis newspaper in *Lefkowitz* stated:

1 Black Lapin Stole Beautiful, worth \$139.50 ... \$1.00
First Come First Served.

Lefkowitz, 86 N.W.2d at 690. The Great Minneapolis Surplus Store had “refused to sell the merchandise to the plaintiff” because of a “house rule” not stated in the ad that “the offer was intended for women only and sales would not be made to men.” *Id.* – Eds.]

purchase of commercial goods, and promises of reward, in which the alleged offer is intended to induce a potential offeree to perform a specific action, often for noncommercial reasons. *James v. Turilli*, 473 S.W.2d 757 (Mo. Ct. App. 1971), arose from a boast by defendant that the “notorious Missouri desperado” Jesse James had not been killed in 1882, as portrayed in song and legend, but had lived under the alias “J. Frank Dalton” at the “Jesse James Museum” operated by none other than defendant. Defendant offered \$10,000 “to anyone who could prove me wrong.” The widow of the outlaw’s son demonstrated, at trial, that the outlaw had in fact been killed in 1882. On appeal, the court held that defendant should be liable to pay the amount offered.

In the present case, the Harrier Jet commercial did not direct that anyone who appeared at Pepsi headquarters with 7,000,000 Pepsi Points on the Fourth of July would receive a Harrier Jet. Instead, the commercial urged consumers to accumulate Pepsi Points and to refer to the Catalog to determine how they could redeem their Pepsi Points. Plaintiff’s understanding of the commercial as an offer must also be rejected because the Court finds that no objective person could reasonably have concluded that the commercial actually offered consumers a Harrier Jet.

*An Objective, Reasonable Person Would Not
Have Considered the Commercial an Offer*

In evaluating the commercial, the Court must not consider defendant’s subjective intent in making the commercial, or plaintiff’s subjective view of what the commercial offered, but what an objective, reasonable person would have understood the commercial to convey. *See Kay-R Elec. Corp. v. Stone & Weber Constr. Co.*, 23 F.3d 55, 57 (2d Cir. 1994) (“We are not concerned with what was going through the heads of the parties at the time [of the alleged contract]. Rather, we are talking about the objective principles of contract law.”)

If it is clear that an offer was not serious, then no offer has been made:

What kind of act creates a power of acceptance and is therefore an offer? It must be an expression of will or intention. It must be an act that leads the offeree reasonably to conclude that a power to create a contract is conferred. This applies to the content of the power as well as to the fact of its existence. *It is on this ground that we must exclude* invitations to deal or acts of mere preliminary negotiation, and *acts evidently done in jest* or without intent to create legal relations.

CORBIN ON CONTRACTS § 1.11 at 30 (emphasis added). An obvious joke, of course, would not give rise to a contract. *See, e.g., Graves v. Northern N.Y. Pub. Co.*, 22 N.Y.S.2d 537 (App. Div. 1940) (dismissing claim to offer of \$ 1000, which appeared in the “joke column” of the newspaper, to any person who could provide a commonly available phone number). On the other hand, if there is no indication that the offer is

“evidently in jest,” and that an objective, reasonable person would find that the offer was serious, then there may be a valid offer. See *Lucy v. Zehmer*, 84 S.E.2d 516, 518, 520 (Va. 1954) (ordering specific performance of a contract to purchase a farm despite defendant's protestation that the transaction was done in jest as “just a bunch of two doggoned drunks bluffing”).

Plaintiff's insistence that the commercial appears to be a serious offer requires the Court to explain why the commercial is funny. Explaining why a joke is funny is a daunting task; as the essayist E.B. White has remarked, “Humor can be dissected, as a frog can, but the thing dies in the process.” The commercial is the embodiment of what defendant appropriately characterizes as “zany humor.”

First, the commercial suggests, as commercials often do, that use of the advertised product will transform what, for most youth, can be a fairly routine and ordinary experience. The military tattoo and stirring martial music, as well as the use of subtitles in a Courier font that scroll terse messages across the screen, such as “MONDAY 7:58 AM,” evoke military and espionage thrillers. The implication of the commercial is that Pepsi Stuff merchandise will inject drama and moment into hitherto unexceptional lives. The commercial in this case thus makes the exaggerated claims similar to those of many television advertisements: that by consuming the featured clothing, car, beer, or potato chips, one will become attractive, stylish, desirable, and admired by all. A reasonable viewer would understand such advertisements as mere puffery, not as statements of fact and refrain from interpreting the promises of the commercial as being literally true.

Second, the callow youth featured in the commercial is a highly improbable pilot, one who could barely be trusted with the keys to his parents' car, much less the prize aircraft of the United States Marine Corps. Rather than checking the fuel gauges on his aircraft, the teenager spends his precious preflight minutes preening. The youth's concern for his coiffure appears to extend to his flying without a helmet. Finally, the teenager's comment that flying a Harrier Jet to school “sure beats the bus” evinces an improbably insouciant attitude toward the relative difficulty and danger of piloting a fighter plane in a residential area, as opposed to taking public transportation.

Third, the notion of traveling to school in a Harrier Jet is an exaggerated adolescent fantasy. In this commercial, the fantasy is underscored by how the teenager's schoolmates gape in admiration, ignoring their physics lesson. The force of the wind generated by the Harrier Jet blows off one teacher's clothes, literally defrocking an authority figure. As if to emphasize the fantastic quality of having a Harrier Jet arrive at school, the Jet lands next to a plebeian bike rack. This fantasy is, of course, extremely unrealistic. No school would provide landing space for a student's fighter jet, or condone the disruption the jet's use would cause.

Fourth, the primary mission of a Harrier Jet, according to the United States Marine Corps, is to “attack and destroy surface targets under day and night visual

conditions.” Manufactured by McDonnell Douglas, the Harrier Jet played a significant role in the air offensive of Operation Desert Storm in 1991. The jet is designed to carry a considerable armament load, including Sidewinder and Maverick missiles. As one news report has noted, “Fully loaded, the Harrier can float like a butterfly and sting like a bee—albeit a roaring 14-ton butterfly and a bee with 9,200 pounds of bombs and missiles.” In light of the Harrier Jet’s well-documented function in attacking and destroying surface and air targets, armed reconnaissance and air interdiction, and offensive and defensive anti-aircraft warfare, depiction of such a jet as a way to get to school in the morning is clearly not serious even if, as plaintiff contends, the jet is capable of being acquired “in a form that eliminates [its] potential for military use.”

Fifth, the number of Pepsi Points the commercial mentions as required to “purchase” the jet is 7,000,000. To amass that number of points, one would have to drink 7,000,000 Pepsis (or roughly 190 Pepsis a day for the next hundred years—an unlikely possibility), or one would have to purchase approximately \$700,000 worth of Pepsi Points. The cost of a Harrier Jet is roughly \$23 million dollars, a fact of which plaintiff was aware when he set out to gather the amount he believed necessary to accept the alleged offer. Even if an objective, reasonable person were not aware of this fact, he would conclude that purchasing a fighter plane for \$700,000 is a deal too good to be true.

Plaintiff argues that a reasonable, objective person would have understood the commercial to make a serious offer of a Harrier Jet because there was “absolutely no distinction in the manner” in which the items in the commercial were presented. Plaintiff also relies upon a press release highlighting the promotional campaign, issued by defendant, in which “no mention is made by [defendant] of humor, or anything of the sort.” These arguments suggest merely that the humor of the promotional campaign was tongue in cheek. Humor is not limited to what Justice Cardozo called “the rough and boisterous joke . . . [that] evokes its own guffaws.” In light of the obvious absurdity of the commercial, the Court rejects plaintiff’s argument that the commercial was not clearly in jest.

Plaintiff argues that additional discovery is necessary on the issues of whether and how defendant reacted to plaintiff’s “acceptance” of their “offer”; how defendant and its employees understood the commercial would be viewed, based on test-marketing the commercial or on their own opinions; and how other individuals actually responded to the commercial when it was aired.

Plaintiff argues that additional discovery is necessary as to how defendant reacted to his “acceptance,” suggesting that it is significant that defendant twice changed the commercial, the first time to increase the number of Pepsi Points required to purchase a Harrier Jet to 700,000,000, and then again to amend the commercial to state the 700,000,000 amount and add “(Just Kidding).” Plaintiff

concludes that, “Obviously, if PepsiCo truly believed that no one could take seriously the offer contained in the original ad that I saw, this change would have been totally unnecessary and superfluous.” The record does not suggest that the change in the amount of points is probative of the seriousness of the offer. The increase in the number of points needed to acquire a Harrier Jet may have been prompted less by the fear that reasonable people would demand Harrier Jets and more by the concern that unreasonable people would threaten frivolous litigation.

Finally, plaintiff’s assertion that he should be afforded an opportunity to determine whether other individuals also tried to accumulate enough Pepsi Points to “purchase” a Harrier Jet is unavailing. The possibility that there were other people who interpreted the commercial as an “offer” of a Harrier Jet does not render that belief any more or less reasonable. The alleged offer must be evaluated on its own terms. Having made the evaluation, the Court concludes that summary judgment is appropriate on the ground that no reasonable, objective person would have understood the commercial to be an offer.

For the reasons stated above, the Court grants defendant’s motion for summary judgment. The Clerk of Court is instructed to close these cases. Any pending motions are moot.

Review Question 1. The *Leonard* court shoots down the plaintiff on two distinct grounds. You should be prepared to articulate the difference between the two.

Review Question 2. The plaintiff here sought additional time from the court to engage in discovery on how other people—especially the “Pepsi Generation” targets of the ad—interpreted it. Judge Kimba Wood was a 55-year-old graduate of the London School of Economics and Harvard Law School who had been a highly regarded antitrust partner at a Wall Street law firm. Was she the sort of person Pepsi expected would collect its Points? Why didn’t she think it relevant to take evidence on how the actual targets of the commercial interpreted it?

Review Question 3. Note how Judge Wood distinguishes *Lucy v. Zehmer* and *Carbolic Smoke Ball*. Do you find her analysis persuasive, or should the court have found the Pepsi commercial to be an offer that Leonard accepted? Why?

FAIRMOUNT GLASS WORKS v. CRUNDEN-MARTIN WOODEN WARE CO.

Court of Appeals of Kentucky 106 Ky. 659, 51 S.W. 196 (1899)

HOBSON, J.

On April 20, 1895, appellee [Crunden-Martin] wrote appellant [Fairmount] the following letter:

St. Louis, Mo., April 20, 1895.

Gentlemen:

Please advise us the lowest price you can make us on our order for ten car loads of Mason green jars, complete, with caps, packed one dozen in case, either delivered here, or f.o.b. cars your place, as you prefer. State terms and cash discount.

Very truly,

Crunden-Martin W. W. Co.

To this letter appellant answered as follows:

Fairmount, Ind., April 23, 1895.

Crunden-Martin Wooden Ware Co.,
St. Louis, Mo.

Gentlemen:

Replying to your favor of April 20th, we quote you Mason fruit jars, complete, in one-dozen boxes, delivered in East St. Louis, Ill.: Pints, \$4.50; quarts, \$5.00; half gallons, \$6.50 per gross, for immediate acceptance, and shipment not later than May 15, 1895; sixty days' acceptance, or 2 off, cash in ten days.

Yours truly,

Fairmount Glass Works.

Please note that we make all quotations and contracts subject to the contingencies of agencies or transportation, delays or accidents beyond our control.

For reply thereto, appellee sent the following telegram on April 24, 1895:

Fairmount Glass Works, Fairmount, Ind.:

Your letter twenty-third received. Enter order ten car loads as per your quotation. Specifications mailed.

Crunden-Martin W. W. Co.

In response to this telegram, appellant sent the following:

Fairmount, Ind., April 24, 1895.

Crunden-Martin W. W. Co., St. Louis, Mo.

Impossible to book your order. Output all sold. See letter.

Fairmount Glass Works.

Appellee insists that, by its telegram sent in answer to the letter of April 23, the contract was closed for the purchase of ten car loads of Mason fruit jars. Appellant insists that the contract was not closed by this telegram, and that it had the right to decline to fill the order at the time it sent its telegram of April 24th. This is the chief question in the case. The court below gave judgment in favor of appellee, and appellant has appealed, earnestly insisting that the judgment is erroneous.

We are referred to a number of authorities holding that a quotation of prices is not an offer to sell, in the sense that a completed contract will arise out of the giving of an order for merchandise in accordance with the proposed terms. There are a number of cases holding that the transaction is not completed until the order so made is accepted. *Smith v. Gowdy*, 90 Mass. 566 (1864); *Beaupre v. Pacific & Atlantic Telegraph Co.*, 21 Minn. 155 (1874).

But each case must turn largely upon the language there used. In this case we think there was more than a quotation of prices, although appellant's letter uses the word "quote" in stating the prices given. The true meaning of the correspondence must be determined by reading it as a whole. Appellee's letter of April 20th, which began the transaction, did not ask for a quotation of prices. It reads: "Please advise us the lowest price you can make us on our order for ten car loads of Mason green jars. . . . State terms and cash discount." From this appellant could not fail to understand that appellee wanted to know at what price it would sell it ten car loads of these jars; so when, in answer, it wrote: "We quote you Mason fruit jars . . . pints \$4.50, quarts \$5.00, half gallons \$6.50 per gross, for immediate acceptance; . . . 2 off, cash in ten days," it must be deemed as intending to give appellee the information it had asked for. We can hardly understand what was meant by the words "for immediate acceptance," unless the latter was intended as a proposition to sell at these prices if accepted immediately. In construing every contract, the aim of the court is to arrive at the intention of the parties. In none of the cases to which we have been

referred on behalf of appellant was there on the face of the correspondence any such expression of intention to make an offer to sell on the terms indicated.

In *Fitzhugh v. Jones*, 20 Va. 83 (1818), the use of the expression that the buyer should reply as soon as possible, in case he was disposed to accede to the terms offered, was held sufficient to show that there was a definite proposition, which was closed by the buyer's acceptance. The expression in appellant [Fairmount's] letter, "for immediate acceptance," taken in connection with appellee's letter, in effect, at what price it would sell it the goods, is, it seems to us, much stronger evidence of a present offer, which, when accepted immediately closed the contract. Appellee's letter was plainly an inquiry for the price and terms on which appellant would sell it the goods, and appellant's answer to it was not a quotation of prices, but a definite offer to sell on the terms indicated, and could not be withdrawn after the terms had been accepted.

Review Question 4. Do you agree with the outcome of this case? (Courts do not always get things right, you know.) As the court infers, a price "quote" is often considered to be more like preliminary negotiation or maybe a limited-purpose advertisement rather than an offer. Fairmount specifically said "we quote you" rather than "we offer you"—so wouldn't the more predictable and merchant-friendly result be to hold that Fairmount's statement was **not** an offer?

Review Question 5. Older contract formation cases, like *Fairmount Glass*, come from the world of letters and telegrams. Does the pervasiveness of e-mail and other instantaneous electronic communications render moot the problems with determining whether an offer occurred? Consider whether the next case suggests that the digital world may not be that different from the earlier age.

KLOIAN v. DOMINO'S PIZZA, L.L.C.

Court of Appeals of Michigan
273 Mich. App. 449, 733 N.W.2d 766 (2006)

PER CURIAM

On August 18, 1994, plaintiff J. Edward Kloian, doing business as Arbor Management Company, entered into a lease agreement with defendant Domino's Pizza, L.L.C. On May 14, 2003, plaintiff, the lessor, initiated this action against defendant, the lessee, alleging that defendant had breached the lease by failing to

pay certain amounts owing for rent, holdover rent, taxes, insurance, maintenance and repair costs, late fees, and other damages related to the removal of equipment.

In March 2005, shortly before the trial date scheduled in this matter, the parties engaged in settlement discussions through their attorneys. Through a series of e-mail messages exchanged between plaintiff's attorney and defendant's attorney, the attorneys agreed that defendant would pay plaintiff \$48,000 to settle the lawsuit in exchange for a release of all possible claims. On March 18, 2005, plaintiff's attorney sent an e-mail to defendant's attorney, stating: "I confirmed with Mr. Kloian that he will accept the payment of \$48,000 in exchange for a dismissal with prejudice of all claims and a release of all possible claims." In response, also on March 18, 2005, defendant's attorney wrote: "Domino's accepts your settlement offer."

Documents reflecting the agreement were prepared by defendant's attorney and sent to plaintiff's attorney for his review. After review of these documents, on March 21, 2005, plaintiff's attorney sent an e-mail to defendant's attorney stating: "I reviewed your documents and find them to be in order. However, Mr. Kloian would like the protection of a mutual release." On March 28, 2005, defendant's attorney sent a response stating: "I have the check and Domino's agreement to a mutual release. I need to revise the prior release and get it to you."

[Plaintiff Kloian subsequently refused to sign the settlement agreement.]

The trial court found that the parties had entered into a binding settlement agreement on March 18, 2005. The trial court issued an order enforcing the settlement agreement and dismissing plaintiff's claims with prejudice.

Plaintiff first contends on appeal that the trial court erred in enforcing the settlement agreement because the parties had not reached an agreement on essential terms. We disagree.

The existence and interpretation of a contract are questions of law reviewed *de novo*. "An agreement to settle a pending lawsuit is a contract and is to be governed by the legal principles applicable to the construction and interpretation of contracts." *Walbridge Aldinger Co. v. Walcon Corp.*, 525 N.W.2d 489 (Mich. Ct. App. 1994). "Before a contract can be completed, there must be an offer and acceptance. Unless an acceptance is unambiguous and in strict conformance with the offer, no contract is formed." *Pakideh v. Franklin Commercial Mortgage Group, Inc.*, 540 N.W.2d 777 (Mich. Ct. App. 1995). Further, a contract requires mutual assent or a meeting of the minds on all the essential terms. *Burkhardt v. Bailey*, 680 N.W.2d 453 (Mich. Ct. App. 2004).

On March 18, 2005, plaintiff's attorney sent an e-mail to defendant's attorney stating that plaintiff would "accept the payment of \$48,000 in change [sic] for a dismissal with prejudice of all claims and a release as [sic] all possible claims." An

attorney has the apparent authority³ to settle a lawsuit on behalf of his or her client. *Nelson v. Consumers Power Co.*, 497 N.W.2d 205 (Mich. Ct. App. 1993). The e-mail from plaintiff’s attorney constituted a settlement offer. “An offer is defined as ‘the manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to that bargain is invited and will conclude it.’” *Eerdmans v. Maki*, 573 N.W.2d 329 (Mich. Ct. App. 1997). In response, defendant’s attorney sent the following e-mail to plaintiff’s attorney:

Domino’s accepts your settlement offer contained in the message below. I spoke with the court, advised it of the settlement and confirmed that we need not appear in court in connection with the settlement. I have ordered a settlement draft from Domino’s in the amount of \$48,000, made payable jointly to Mr. Kloian and your firm. I will forward a stipulation and order for dismissal with prejudice and a release for approval by you and Mr. Kloian respectively. You should have them in the next few days. Please call with any questions. I’m pleased we were able to resolve this matter without trial. - Neil

The e-mail from defendant’s attorney constituted an acceptance of plaintiff’s settlement offer. There clearly was a meeting of the minds on the essential terms of the agreement.

Affirmed.

Review Question 6. What do you think about the possibility of a legally-binding contract arising from an e-mail exchange? Read the prefatory note and sections 5 and 7 of the Uniform Electronic Transactions Act (UETA) to see one example of a statute that deals with the possibility of a legally-operative “writing” being in electronic form. You can find UETA in many Contracts statutory supplements, or you can also find it online here:

http://www.uniformlaws.org/shared/docs/electronic%20transactions/ueta_final_99.pdf.

We will explore issues of electronic contracting at various points in the course.

³ [“Apparent authority” is a concept you will most likely see later in a Business Associations course, but for now, and in this case, it means that lawyers—like you—will ordinarily be assumed to have authority to bind their clients to an agreement. Practice tip: make very, very sure you have the client’s consent before you bind the client to any contracts, including settlement agreements.—Eds.]

EVER-TITE ROOFING CORP. v. GREEN
Court of Appeal of Louisiana, Second Circuit
83 So. 2d 449 (1955)

AYRES, J.

Defendants executed and signed an instrument June 10, 1953, for the purpose of obtaining the services of plaintiff in re-roofing their residence situated in Webster Parish, Louisiana. The document set out in detail the work to be done and the price therefor to be paid in monthly installments. This instrument was likewise signed by plaintiff's sale representative, who, however, was without authority to accept the contract for and on behalf of the plaintiff. This alleged contract contained these provisions:

This agreement shall become binding only upon written acceptance hereof, by the principal or authorized officer of the Contractor, or upon commencing performance of the work. * * * This written agreement is the only and entire contract covering the subject matter hereof and no other representations have been made unto Owner except these herein contained. No guarantee on repair work, partial roof jobs, or paint jobs.

Inasmuch as this work was to be performed entirely on credit, it was necessary for plaintiff to obtain credit reports and approval from the lending institution which was to finance said contract. With this procedure defendants were more or less familiar and knew their credit rating would have to be checked and a report made. On receipt of the proposed contract in plaintiff's office on the day following its execution, plaintiff requested a credit report, which was made after investigation and which was received in due course and submitted by plaintiff to the lending agency. Additional information was requested by this institution, which was likewise in due course transmitted to the institution, which then gave its approval.

The day immediately following this approval, which was either June 18 or 19, 1953, plaintiff engaged its workmen and two trucks, loaded the trucks with the necessary roofing materials and proceeded from Shreveport to defendants' residence for the purpose of doing the work and performing the services allegedly contracted for the defendants. Upon their arrival at defendants' residence, the workmen found others in the performance of the work which plaintiff had contracted to do. Defendants notified plaintiff's workmen that the work had been contracted to other parties two days before and forbade them to do the work.

Formal acceptance of the contract was not made under the signature and approval of an agent of plaintiff. It was, however, the intention of plaintiff to accept the contract by commencing the work, which was one of the ways provided for in the instrument for its acceptance, as will be shown by reference to the extract from the contract quoted hereinabove.

The basis of the judgment appealed was that defendants had timely notified plaintiff before “commencing performance of work.” The trial court held that notice to plaintiff’s workmen upon their arrival with the materials that defendants did not desire them to commence the actual work was sufficient and timely to signify their intention to withdraw from the contract. With this conclusion we find ourselves unable to agree.

Defendants’ attempt to justify their delay in thus notifying plaintiff for the reason they did not know where or how to contact plaintiff is without merit. The contract itself, a copy of which was left with them, conspicuously displayed plaintiff’s name, address and telephone number. Be that as it may, defendants at no time, from June 10, 1953, until plaintiff’s workmen arrived for the purpose of commencing the work, notified or attempted to notify plaintiff of their intention to abrogate, terminate or cancel the contract.

Defendants evidently knew this work was to be processed through plaintiff’s Shreveport office. The record discloses no unreasonable delay on plaintiff’s part in receiving, processing or accepting the contract or in commencing the work contracted to be done. No time limit was specified in the contract within which it was to be accepted or within which the work was to be begun. It was nevertheless understood between the parties that some delay would ensue before the acceptance of the contract and the commencement of the work, due to the necessity of compliance with the requirements relative to financing the job through a lending agency. The evidence as referred to hereinabove shows that plaintiff proceeded with due diligence.

The general rule of law is that an offer proposed may be withdrawn before its acceptance and that no obligation is incurred thereby. This is, however, not without exceptions. For instance, Restatement of the Law of Contracts [section 40]⁴ stated:

(1) The power to create a contract by acceptance of an offer terminates at the time specified in the offer, or, if no time is specified, at the end of a reasonable time.

[(2)] What is a reasonable time is a question of fact depending on the nature of the contract proposed, the usages of business and other circumstances of the case which the offeree at the time of his acceptance either knows or has reason to know.

Therefore, since the contract did not specify the time within which it was to be accepted or within which the work was to have been commenced, a reasonable time must be allowed therefor in accordance with the facts and circumstances and the evident intention of the parties. A reasonable time is contemplated where no time is

⁴ [The court here is citing the first Restatement of Contracts. See section 41 of the Restatement (Second) of Contracts for the updated version of the quoted section. – Eds.]

expressed. What is a reasonable time depends more or less upon the circumstances surrounding each particular case. The delays to process defendants' application were not unusual. The contract was accepted by plaintiff by the commencement of the performance of the work contracted to be done. This commencement began with the loading of the trucks with the necessary materials in Shreveport and transporting such materials and the workmen to defendants' residence. Actual commencement or performance of the work therefore began before any notice of dissent by defendants was given plaintiff. The proposition and its acceptance thus became a completed contract.

By their aforesaid acts defendants breached the contract. They employed others to do the work contracted to be done by plaintiff and forbade plaintiff's workmen to engage upon that undertaking. By this breach defendants are legally bound to respond to plaintiff in damages. . . .

For the reasons assigned, the judgment appealed is annulled, avoided, reversed and set aside and there is now judgment in favor of plaintiff, Ever-Tite Roofing Corporation, against the defendants, G. T. Green and Mrs. Jessie Fay Green, for the full sum of \$ 311.37, with 5 per cent per annum interest thereon from judicial demand until paid, and for all costs.

Reversed and rendered.

Review Question 7. Who made the offer here? Ever-Tite wrote the contract and handed it to the Greens. Why isn't Ever-Tite the offeror?

Review Question 8. Assume that you are a transactional lawyer hired to represent Ever-Tite Roofing Corp. by revising its form contract—particularly the provision quoted in this case. How do you protect your client against future versions of the argument raised by the Greens—but simultaneously protect your client from accidentally being bound to unwanted contracts (as that seems to have been a concern of the original drafter)? Try writing out a proposed revision.

Problems

Problem 4.1

A vending machine in the student lounge carries several types of beverages. Leonard wants a beverage. On the front of the machine is a large button that says "Pepsi Cola \$1.00." Leonard inserts the dollar and presses the button. The machine flashes a light that says "sold out" and does not deliver the Pepsi Cola. Instead, it returns Leonard's \$1 bill. Who—if anyone—is the offeror in this transaction and who

is the offeree? Was a contract formed between the parties? If so, was the contract breached?

Problem 4.2

Sheldon saw the same commercial that Leonard saw in *Leonard v. Pepsico, Inc.* He wanted the Pepsi leather jacket for 1,450 Pepsi points—which he could earn by purchasing 1,450 individual Pepsi bottles or 725 six-packs of cans. He accumulated the points and submitted them to Pepsi. Pepsi subsequently notified him that they rejected his offer for the leather jacket and returned the Pepsi Points to him. When he complained, Pepsi informed him that neither its television commercial nor its catalogue was an “offer” and therefore no contract was ever formed. Does Sheldon have any contractual rights against Pepsi? Why or why not?

Problem 4.3

Kershaw, a salt dealer in Milwaukee, Wisconsin, sent an e-mail message to Morton, a retailer in La Crosse who sold large amounts of rock salt:

Date: September 19, 20XX.

In consequence of recent disruption in the salt trade, we are authorized to offer Michigan rock salt, in full car-load lots of eight to eleven tons, delivered at your city, at \$50 per ton, to be shipped by railcar only. At this price it is a bargain, as the price in general remains unchanged. I'd be pleased to receive your order.

Yours truly,

C. J. KERSHAW & SON

Morton replied the next day by e-mail:

Date: September 20, 20XX.

Just saw your e-mail from yesterday. Please ship me two thousand tons Michigan rock salt, as offered in yesterday. Please confirm.

J. H. MORTON

The next day, Kershaw refused to supply the salt. Morton sued, arguing that Kershaw's letter was an offer. Based on the materials you read in this unit, was it? Why or why not?

Unit 5: Problems with Offers

CONTRACT FORMATION Part Three

FOCUS OF THIS UNIT

We now know—see Restatement (Second) of Contracts § 24—that an offer is a statement of willingness to enter into a bargain that is made in such a way that the offeree reasonably understands that if she accepts the offer, a contract will be formed. Thus, a statement that “I hereby offer to sell you my 1988 Ford Crown Victoria for \$2,500,” would clearly be an offer.

But how long does that offer stay open? Remember that the offer creates a *power* in the offeree to make a binding contract. Once the offer is made, the offeror is to some extent at the mercy of the offeree. And most of us do not want to be on the hook indefinitely. Most of us understand this inherently. If someone offered to sell you a house in Los Angeles for \$10,000 in 1957, could you wait until 2017 to accept?

Nothing Lasts Forever. As we will see, offers—like milk—eventually spoil at some point. Offers can be terminated in several ways. A rejection of the offer terminates it, as does a counter-offer. Thus:

THELMA: I'll sell you my 1988 Ford Crown Victoria for \$2,500.

LOUISE: No, thanks.

THELMA: Okay.

LOUISE: No, wait. I changed my mind. Yes.

Here, the statement “No, thanks” is, in legal terminology, a *rejection*. An offer ends when it is rejected. At this point there is no contract. (Of course, Thelma would be free to treat Louise's last statement as a new offer that she might accept.) Similarly:

THELMA: I'll sell you my 1988 Ford Crown Victoria for \$2,500.

LOUISE: No, but I'll give you \$2,000.

Here, we have a *counter-offer*. The counter-offer also terminates the first offer. If Thelma doesn't accept the \$2,000, there is no contract. Of course, if Thelma says, “You've got a deal!” there is a contract because Thelma accepted Louise's counter-

offer. These are simple examples; as you will see from the cases below, things can get more complicated.

“Master of the Offer.” Note that it is the offeror who gets to control the content of the offer, to specify exactly what is wanted. We thus frequently say that the offeror is “master of the offer.” What does that mean? It means that the offeror gets to specify exactly when and how the offeree must go about accepting the offer. (The issue of what constitutes acceptance is the subject of the next unit.) Thus, if an offer specifies a time that it will remain open or a time it will end, it terminates at precisely that time—assuming it hasn’t terminated earlier for some reason. As you can see from the following, there are several other ways that an offer can be cut off.

In connection with this unit, you may find it helpful to read—or at least skim over—sections 30, 32, 36, 38-43, and 48 of the Restatement (Second) of Contracts.

Cases and Materials

IN RE ESTATE OF SEVERTSON

Court of Appeals of Minnesota
1998 Minn. App. LEXIS 243 (March 3, 1998)

WILLIS, J.

Respondents Kathy and Mark Thorson and the decedent, Helen Severtson, were neighbors for approximately 14 years, during which time they became good friends. After Severtson’s husband died in 1993, the Thorsons spent substantial time with Severtson. Kathy Thorson visited with her almost daily when she took Severtson her mail. Mark Thorson did odd jobs for Severtson when needed.

The Thorsons had told both Severtson and her husband on several occasions that they would be interested in purchasing the Severtsons’ property if they ever wanted to sell it. On February 16, 1996, Severtson and the Thorsons signed a typed document that provides:

I, Helen Severtson, give Mark and Kathy Thorson first option to purchase my farmsite, all buildings, including the quonset home, rock quarry, including any leased quarry rights, and adjoining farm land. * * * *

Purchase price agreed upon is \$100,000, to be paid to Helen Severtson if living or to the Estate of Helen Severtson if she is deceased or incapacitated to deal with sale of above listed property.

Any persons occupying the quonset home will vacate and leave property in good repair before or upon closure date on above property.

There is a hand-written addendum, initialed by the parties, that provides:

In the event that Helen Severtson should die suddenly, persons in the quonset home will be given three months to vacate all premises and to leave them in good repair, otherwise under any other conditions the above will apply.

Myron Danielson, another of Severtson's neighbors, testified that he drafted the typewritten portion of the document but was not actually present when the Thorsons or Severtson signed it. Danielson also testified that he drafted the document for Severtson so "that there would be some legal document that her wishes would be carried out" and so there would not be litigation over the matter.

Severtson died on August 4, 1996. The Thorsons recorded the document with the Dodge County Recorder in September 1996 as an option contract. On October 17, 1996, the Thorsons notified Inez Breiter, the personal representative of Helen Severtson's estate, of their intent to purchase Severtson's property. When the estate's representative disallowed their claim, the Thorsons petitioned the district court for relief.

After a hearing, the district court rejected the Thorsons' argument that the document signed by Severtson and the Thorsons is an option to purchase property, concluding that there was no consideration separate and distinct from a promise to pay the purchase price. But the court found that a bilateral contract for the purchase of land was created because (1) Severtson offered to sell her property; (2) the offer to sell survived her death; and (3) the Thorsons accepted the offer by notifying the estate's representative of their intent to purchase. The Thorsons and the estate's representative both moved the court for amended findings, and the court issued its amended findings of fact, conclusions of law, order, and judgment on June 30, 1997. The court concluded that "the Thorsons were entitled to possession [of the property] within 90 days of [Severtson's] death or their acceptance of the offer." Because both of those dates had already passed, the court ordered that Thorsons were entitled to possession of the property within 90 days after the date of its order. This appeal followed.

"The construction and effect of a contract are questions of law for the court." *Turner v. Alpha Phi Sorority House*, 276 N.W.2d 63, 66 (Minn. 1979). "The court's role in interpreting a contract is to ascertain and give effect to the intention of the parties." *Metropolitan Sports Facilities Comm'n v. General Mills, Inc.*, 470 N.W.2d 118, 122-23 (Minn. 1991). But the court may only give effect to the parties' intent if that can be done consistently with established legal principles. *Republic Nat'l Life Ins. Co. v. Lorraine Realty Corp.*, 279 N.W.2d 349, 354 (Minn. 1979).

The estate's representative argues that the district court erred in concluding that Severtson offered to sell her property to the Thorsons, based on the fact that the document they signed gives the Thorsons a "first option to purchase" the Severtson property. An offer is conduct that empowers an offeree to create a contract by his or her acceptance. *League General Ins. Co. v. Tvedt*, 317 N.W.2d 40, 43 (Minn. 1982). Where we can ascertain the parties' intent from the written contract, we do not "remake the contract" by construing it differently. *Art Goebel, Inc. v. North Suburban Agencies, Inc.*, 567 N.W.2d 511, 516 (Minn. 1997). The document signed by Severtson and the Thorsons recites no conditions precedent to the exercise of the Thorsons' "first option to purchase"; it unambiguously manifests Severtson's intent to sell her property to the Thorsons. The district court, therefore, did not err in concluding that Severtson offered to sell her property to the Thorsons.

The estate's representative argues that if Severtson did offer to sell her property, the district court erred in finding that the offer did not terminate on Severtson's death. The district court relied on the Restatement (Second) of Contracts § 36 (1981), which provides:

(1) An offeree's power of acceptance may be terminated by

[(a) rejection or counter-offer by the offeree, or

(b) lapse of time, or

(c) revocation by the offeror, or]

(d) death or incapacity of the offeror or offeree.

[(2) In addition, an offeree's power of acceptance is terminated by the non-occurrence of any condition of acceptance under the terms of the offer.]

See also Cooke v. Belzer, 413 N.W.2d 623, 627 (Minn. App. 1987) (citing section 36 of the Restatement). Noting that section 36 states that an offeror's death may terminate an offeree's power to accept, the district court concluded that an offeror's death does not automatically terminate an offer. The court found that the offer did not terminate here because Severtson intended her offer to remain open even if she died before it was accepted. But section 36 of the Restatement simply lists alternative methods by which an offeree's power to accept is terminated, while sections 36-49 discuss the specific circumstances under which each method applies. Rest. 2d § 36, cmt. a. Section 48 provides that

an offeree's power of acceptance is terminated when the offeree or offeror dies or is deprived of legal capacity to enter into the proposed contract.

See also Heideman v. Northwestern Nat'l Life Ins. Co., 546 N.W.2d 760, 764 (Minn. App. 1996) (adopting section 48 of the restatement).

The basis for the rule is described by Professor Williston in his treatise on contracts:

Assuming that the formation of a contract requires mutual mental assent of the parties, and offer and acceptance [are] merely evidence of such assent, it would be obviously impossible that a contract should be formed where either party to the transaction died before this assent was obtained. That such assent was formerly thought necessary seems probable, and as to death, this theory is still maintained. Accordingly, it is generally held that the death of the offeror terminates the offer.

1 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 62 (3d ed. 1957). Although Severtson may have intended for her offer to survive her death, we cannot harmonize that intent with the established legal principle that an offer terminates on the death of the offeror.

The Thorsons cite, as did the district court, *Frederick v. Peoples State Bank of Madison Lake*, 385 N.W.2d 11 (Minn. App. 1986). The court in *Frederick*, in turn, cites the New Jersey Superior Court for the proposition that

where the owner of real property enters into a contract of sale and then dies before executing a deed * * *, the other party may enforce the contract against the owner's estate, the theory being that equitable title to the property vests in the vendee as soon as the contract was executed, subject, however, to a lien in favor of the vendor for the unpaid purchase price. * * * Such contracts, therefore, are enforceable, even though one of the parties thereto may die before performance is had.

Id. at 15. But because the Thorsons did not accept Severtson's offer before she died, there was no contract for sale at the time of Severtson's death. The issue is not whether a contract for sale survives Severtson's death, but whether her offer to enter into a contract for sale survives her death. Because the document signed by Severtson and the Thorsons is properly characterized as an offer to sell, the Thorsons' power to accept the offer terminated when Severtson died.

The Thorsons argue that the document should be treated as an option to purchase. But the district court found that it is not an option, and because the Thorsons did not raise this issue in a notice of review, it is not properly before this court. *See* Minn. R. Civ. App. P. 106 (explaining respondent's right to obtain review).¹ Nevertheless, we note that the record supports the district court's determination that there was no legal consideration here separate and distinct from the promise to pay

¹ [By the court] The Thorsons argue that Restatement (Second) of Contracts § 37 applies to the document. Section 37 provides that under an option contract, the right to accept "is not . . . terminated . . . by death . . . of the offeror, unless the requirements are met for the discharge of a contractual duty." Because the document is not an option contract, section 37 does not apply.

the purchase price. And the district court correctly concluded that without such consideration, the document is not an option to purchase. *See Country Club Oil Co. v. Lee*, 58 N.W.2d 247, 250 (Minn. 1953).

Because the document at issue was an offer to sell that terminated on Severtson's death, the district court erred in finding that a bilateral contract for the purchase of real estate was created when the Thorsons gave the personal representative of Severtson's estate notice of their intent to purchase the Severtson property.

Review Question 1. The *Severtson* court notes that the document signed by Helen was not an "option" to purchase the property. Why not? What would have made this an enforceable option contract? You should consider section 25 of the Restatement (Second) of Contracts—even though you may not find it to be as enlightening as you might wish.

PETTERSON v. PATTBERG
Court of Appeals of New York
248 N.Y. 86, 161 N.E. 428 (1928)

KELLOGG, J.

[Pattberg held a mortgage of \$5,450 on Petterson's home at 5301 Sixth Ave., Brooklyn, N.Y., which had five years left to run. Pattberg wrote to Petterson saying that if "said mortgage [was] paid" by Petterson "on or before May 31, 1924," Pattberg would allow Petterson to pay \$780 less than the amount owed.]

Subsequently, on a day in the latter part of May, 1924, Petterson presented himself at the defendant's home, and knocked at the door. The defendant demanded the name of his caller. Petterson replied: "It is Mr. Petterson. I have come to pay off the mortgage." The defendant answered that he had sold the mortgage [to someone else]. Petterson stated that he would like to talk with the defendant, so the defendant partly opened the door. Thereupon Petterson exhibited the cash and said he was ready to pay off the mortgage according to the agreement. The defendant refused to take the money. It, therefore, became necessary for Petterson to pay to [the new mortgagor] the full amount of the bond and mortgage. It is claimed that he thereby sustained a loss of \$780, the sum which the defendant agreed to allow upon the bond and mortgage if payment in full of principal, less that sum, was made on or before

May 31st, 1924. The plaintiff has had a recovery for the sum thus claimed, with interest.

Clearly the defendant's letter proposed to Petterson the making of a unilateral contract, the gift of a promise in exchange for the performance of an act. The thing conditionally promised by the defendant was the reduction of the mortgage debt. The act requested to be done, in consideration of the offered promise, was payment in full of the reduced principal of the debt prior to the due date thereof. "If an act is requested, that very act and no other must be given." SAMUEL WILLISTON, *THE LAW OF CONTRACTS* § 73 (1927). It is elementary that any offer to enter into a unilateral contract may be withdrawn before the act requested to be done has been performed. A bidder at a sheriff's sale may revoke his bid at any time before the property is struck down to him. The offer of a reward in consideration of an act to be performed is revocable before the very act requested has been done. So, also, an offer to pay a broker commissions, upon a sale of land for the offeror, is revocable at any time before the land is sold, although prior to revocation the broker performs services in an effort to effectuate a sale.

An interesting question arises when, as here, the offeree approaches the offeror with the intention of proffering performance and, before actual tender is made, the offer is withdrawn. Of such a case Williston says: "The offeror may see the approach of the offeree and know that an acceptance is contemplated. If the offeror can say 'I revoke' before the offeree accepts, however brief the interval of time between the two acts, there is no escape from the conclusion that the offer is terminated." WILLISTON, *supra*, § 60-b. In this instance Petterson, standing at the door of the defendant's house, stated to the defendant that he had come to pay off the mortgage. Before a tender of the necessary moneys had been made the defendant informed Petterson that he had sold the mortgage. That was a definite notice to Petterson that the defendant could not perform his offered promise and that a tender to the defendant, who was no longer the creditor, would be ineffective to satisfy the debt. "An offer to sell property may be withdrawn before acceptance without any formal notice to the person to whom the offer is made. It is sufficient if that person has actual knowledge that the person who made the offer has done some act inconsistent with the continuance of the offer, such as selling the property to a third person." *Dickinson v. Dodds*, [1876] 2 Ch. Div. 463. To the same effect is *Coleman v. Applegarth*, 68 Md. 21 (1887).

Thus, it clearly appears that the defendant's offer was withdrawn before its acceptance had been tendered. It is unnecessary to determine, therefore, what the legal situation might have been had tender been made before withdrawal. It is the individual view of the writer that the same result would follow. This would be so, for the act requested to be performed was the completed act of payment, a thing incapable of performance unless assented to by the person to be paid. WILLISTON,

supra, § 60-b. Clearly an offering party has the right to name the precise act performance of which would convert his offer into a binding promise. Whatever the act may be until it is performed the offer must be revocable. However, the supposed case is not before us for decision. We think that in this particular instance the offer of the defendant was withdrawn before it became a binding promise, and, therefore, that no contract was ever made for the breach of which the plaintiff may claim damages.

The judgment of the Appellate Division and that of the Trial Term should be reversed and the complaint dismissed, with costs in all courts.

LEHMAN, J. (dissenting).

The promise made by the defendant was not made as a gift or mere gratuity to the plaintiff. It was made for the purpose of obtaining from the defendant something which the plaintiff desired. It constituted an offer which was to become binding whenever the plaintiff should give, in return for the defendant's promise, exactly the consideration which the defendant requested.

Here the defendant requested no counter promise from the plaintiff. The consideration requested by the defendant for his promise to accept payment was, I agree, some act to be performed by the plaintiff. Until the act requested was performed, the defendant might undoubtedly revoke his offer. Our problem is to determine from the words of the letter read in the light of surrounding circumstances what act the defendant requested as consideration for his promise.

The defendant undoubtedly made his offer as an inducement to the plaintiff to "pay" the mortgage before it was due. Therefore, it is said, that "the act requested to be performed was the completed act of payment, a thing incapable of performance unless assented to by the person to be paid." In unmistakable terms the defendant agreed to accept payment, yet we are told that the defendant intended, and the plaintiff should have understood, that the act requested by the defendant, as consideration for his promise to accept payment, included performance by the defendant himself of the very promise for which the act was to be consideration. The defendant's promise was to become binding only when fully performed; and part of the consideration to be furnished by the plaintiff for the defendant's promise was to be the performance of that promise by the defendant. So construed, the defendant's promise or offer, though intended to induce action by the plaintiff, is but a snare and delusion. The plaintiff could not reasonably suppose that the defendant was asking him to procure the performance by the defendant of the very act which the defendant promised to do, yet we are told that even after the plaintiff done all else which the defendant requested, the defendant's promise was still not binding because the defendant chose not to perform.

I cannot believe that a result so extraordinary could have been intended when the defendant wrote the letter. "The thought behind the phrase proclaims itself

misread when the outcome of the reading is injustice or absurdity.” *Surace v. Danna*, 161 N.E. 315 (N.Y. 1928) (Cardozo, C.J.). If the defendant intended to induce payment by the plaintiff and yet reserve the right to refuse payment when offered he should have used a phrase better calculated to express his meaning than the words: “I agree to accept.” A promise to accept payment, by its very terms, must necessarily become binding, if at all, not later than when a present offer to pay is made.

Under a fair construction of the words of the letter I think the plaintiff had done the act which the defendant requested as consideration for his promise. The plaintiff offered to pay with present intention and ability to make that payment.

The judgment should be affirmed.

Review Question 2. The majority and the dissent in *Petterson v. Pattberg* do not appear to disagree about the underlying rules on revocation of an offer, yet they have very different characterizations of what the facts of the case actually mean for purposes of applying those rules. See Restatement (Second) of Contracts §§ 35, 42. Whose reading of the facts and their legal meaning do you find more persuasive, Judge Kellogg’s majority opinion or Judge Lehman’s dissent? Why?

CONFEDERATE MOTORS, INC. v. TERNY

United States District Court for the District of Massachusetts
831 F. Supp. 2d 414 (D. Mass. 2011)

JUDITH GAIL DEIN , U.S.M.J.

This matter is before the court on Confederate Motors, Inc.’s “Motion to Enforce Settlement.” By this motion, Confederate contends that it reached a settlement agreement with the defendant, Francois-Xavier Terny, through attorney emails. Terny denies that a settlement had been reached.

[Confederate Motors was an American custom motorcycle manufacturer, whose chair was Herbert Chambers. Francois-Xavier Terny, a financier, invested in Confederate, was named to its board, and signed a consulting agreement to help it with distribution. The parties ultimately fell out in an acrimonious dispute. Although the agreement with Terny contained a forum selection clause requiring all litigation among the parties to be brought in Massachusetts, Confederate ultimately sued Terny for claimed breach of contract in Alabama. Terny moved to transfer the litigation to Massachusetts.]

On December 13, 2010, Terny, through his counsel Laurence McDuff, filed a Motion to Enforce Forum Section Clause seeking to have the Alabama case dismissed, with leave to have Confederate refile it in Massachusetts. On December 15, 2010 the motion was scheduled for oral argument on January 21, 2011. Meanwhile, counsel for both parties had begun to explore a possible settlement. In a December 9, 2010 email, Chance Turner (attorney for Confederate) proposed the following:

We feel a reasonable solution for all parties is the mutual release of all existing claims, the return of the consulting shares (505,000) to the corporation, and one hundred and fifty thousand dollars for fees, expenses and compensatory damages. I believe my client would be interested in accepting all corporate shares now in your client's possession in lieu of a cash payment. Please respond to this offer within two weeks.

Laurence McDuff (attorney for Terny) replied six days later, on December 15, with a "counteroffer" in which Terny "will agree to return the 505,000 shares, and execute mutual releases, but he is not willing to pay the monetary component of your offer." He concluded with "[h]opefully we can work something out along these lines." Attorney Turner responded one week later, on December 22, 2010. In his email he wrote:

I spoke with my client regarding your counteroffer. In the interest of settlement, we can reduce the monetary component to one hundred thousand. Let me know what your client thinks.

Attorney McDuff replied six days later, on December 28. In his email he wrote:

Francois still is willing to return the 505,000 shares and execute mutual releases, but he declines to pay you any monetary component.

Attorney Turner did not reply.

The litigation proceeded. Oral argument was heard on January 21, 2011 in the Alabama District Court. Confederate opposed the motion to enforce the forum selection clause. At the hearing, the court denied the request that the action be dismissed, but granted the alternative relief that the case be transferred to Massachusetts. This was confirmed by a written order on January 24, 2011.

On January 24, 2011, nearly four weeks after Attorney McDuff's last email regarding a possible settlement, Attorney Turner sent Attorney McDuff the following email:

After lengthy discussions with my client, we are prepared to accept your last offer of settlement under the terms set forth in your last email. Please give me a call or e-mail tomorrow to discuss this issue. Thanks.

This was apparently in response to Attorney McDuff's December 28th communication quoted above. Attorney McDuff responded on January 25, 2011, writing that he had "forwarded this to Francois [Terny] and will get back with you when I have his response." On January 26, 2011, Attorney McDuff followed up with an email to Attorney Turner stating:

Chance, now that the case is being transferred, my client has asked me to let Eric Galler handle any further settlement discussions. Eric is aware of your last offer.

Attorney McDuff then provided Attorney Galler's contact information. Attorney Turner did not object to the characterization of his January 24th communication as an "offer," nor did he indicate that there was no need for further "settlement discussions" since a deal had been struck. Rather, on February 3, 2011, he sent the following email to Attorney Galler:

I apologize for not contacting you sooner. I've been in trial this week. I just wanted to touch base before the case was transferred to Boston. At this time, we accept the last offer on 12/28/10 from Mr. Terny. There has been no retraction of that written offer, so I am under the impression that offer is still valid. Please let me know your position as soon as possible. We are experiencing a winter storm here, so I may be unable to get to the office tomorrow.

No further settlement discussions took place and no draft documents were exchanged. Rather, on February 22, 2011, Terny filed claims against Confederate and Chambers in this court, including claims for breach of fiduciary duty, violation of the Blue Sky laws, fraud, and negligent misrepresentation. In addition to seeking monetary damages, Terny is seeking a declaration that he is the owner of 805,000 shares of Confederate. On March 14, 2011, Confederate filed the instant motion to enforce the settlement agreement.

In the formation of a contract, an offer must be matched by an acceptance. A counteroffer proposing a term that is materially different from that contained in the original offer constitutes a rejection of the offer and negates any agreement. Moreover, it is hornbook law that an offeree's power of acceptance vanishes "at the time specified in the offer, and if no deadline is prescribed, at the end of a reasonable time." *Mathewson*, 827 F.2d at 853. *See also* Restatement (Second) of Contracts § 41(1) (1981) ("An offeree's power of acceptance is terminated at the time specified in the offer, or, if no time is specified, at the end of a reasonable time"). Finally, in order for an enforceable contract to exist, the parties must have reached an agreement on all essential terms. *See, e.g., Situation Mgmt. Sys., Inc. v. Malouf, Inc.*, 724 N.E.2d 699, 703 (Mass. 2000) ("It is axiomatic that to create an enforceable contract, there must be agreement between the parties on the material terms of that contract, and the parties must have a present intention to be bound by that agreement."); *Sagamore*

Ins. Co. v. Sudduth, 45 So.3d 1286, 1290 (Ala. Ct. Civ. App. 2010) (“settlement agreements, like other agreements, are not valid when there has been no meeting of the minds with regard to the final terms of the agreement”). Application of these principles to the instant case compels the conclusion that there is no enforceable settlement agreement.

Assuming, *arguendo*, that Attorney McDuff’s email of December 28th was a firm offer, it had expired before Confederate responded a month later, on January 24th. Under the circumstances of these parties’ interactions, the response was not made within a reasonable time.

In its initial offer, Confederate made it clear that negotiations were to proceed at a fairly rapid pace: thus in his December 9th email, Attorney Turner requested a response “within two weeks.” Thereafter, the parties responded to each other in no more than a week, with Attorney McDuff responding on December 15, 2010, Attorney Turner responding on December 22, 2010 and then Attorney McDuff replying on December 28, 2010. Thus, the parties clearly intended that any response would be made promptly. There is no basis in the record for Confederate to have assumed that an offer would remain open for a month. See *Crellin Techs., Inc. v. Equipmentlease Corp.*, 18 F.3d 1, 9 (1st Cir. 1994) (“four months is an unreasonably long time for a financing offer to remain open” given “rapidly fluctuating interest rates” so “it would have been thoroughly unreasonable for appellant to believe that a sale/leaseback proposal made in November and not then accepted would linger on the table until the following March”).

Moreover, there are “no objective facts to suggest” that Confederate believed that the “offer” of December 28th remained open as of the time of the hearing. For example, on January 18, 2011 Confederate affirmatively filed a response to the pending motion to enforce the forum selection clause, without indicating that the parties were engaged in settlement negotiations. At the oral argument on January 21, 2011, Confederate again did not represent to the court that it was engaged in settlement discussions but, rather, addressed the motion on the merits. In fact, at no time during the period between December 28th and January 21st did Attorney Turner indicate that his client was considering the “offer.” Even after the ruling adverse to Confederate on January 21, 2011, Attorney Turner contends that he asked if “that offer [was] still open” because his client might “reconsider its position” as a result of the transfer of the case to Massachusetts. Such conduct makes it clear that Confederate’s attorney knew that there was no outstanding offer for Confederate to accept at the time of the Alabama court’s ruling.

For the reasons detailed herein, the Plaintiff’s Motion to Enforce Settlement, Docket No. 88, is DENIED.

Review Question 3. In the case of *New Headley Tobacco Warehouse Co. v. Gentry's Executor*, 212 S.W. 325 (Ky. Ct. App. 1948), a landlord's offer to extend a lease "[i]n the event you build within the next five years . . . an addition to your warehouse" remained open for about three-and-a-half years, ending when the landlord died. In *Confederate Motors*, however, the offer from December 28, 2010 didn't even survive a full month, given that Attorney Turner's January 24, 2011 acceptance correspondence did not create a contract. How can both of these opinions be right? What traits did the offer in *Confederate Motors* have that caused it to have such a short lifespan? Why, in contrast, could the offer in *New Headley Tobacco* remain open for well over three years?

POEL v. BRUNSWICK-BALKE-COLLENDER CO.

Court of Appeals of New York
216 N.Y. 310, 110 N.E. 619 (1915)

SEABURY, J.

[Poel & Arnold was a rubber importer. Brunswick was (and is) a manufacturer of various items made from rubber, including pool tables, bowling balls, and tires. The parties exchanged a series of letters, and Poel claimed that a contract was made. When Brunswick refused to accept the rubber, Poel sued.]

There are in this case four writings and upon three of them this controversy must be determined. They set forth with accuracy and precision the transaction between the parties. The oral evidence that was presented is in no way inconsistent with the writings, and if it were the spoken words could not be permitted to prevail over the written. The writings referred to are as follows:

[Mr. Kelly of Poel & Arnold to Brunswick, April 2, 1910]

As per telephonic conversation with your Mr. Rogers to-day, this is to confirm having your offer of \$2.42 per pound for 12 tons Upriver Fine Para Rubber, for shipment either from Brazil or Liverpool, in equal monthly parts January to June, 1911, about which we will let you know upon receipt of our cable reply on Monday morning.

[Mr. Kelly of Poel & Arnold to Brunswick, April 4, 1910]

Enclosed, we beg to hand you contract for 12 tons Upriver Fine Para Rubber, as sold you today, with our thanks for the order.

[Attached to the latter is the following:]

Sold to You:

For equal monthly shipments January to June, 1911, from Brazil and/or Liverpool, about twelve (12) tons Upriver Fine Para Rubber at Two Dollars and forty-two cents (\$ 2.42) per pound; payable in U. S. Gold or its equivalent, cash twenty (20) days from date of delivery here.

[Mr. Rogers of Brunswick to Poel & Arnold, April 6, 1910; handwritten portions of form are italicized):

Please deliver at once the following, and send invoice with goods:

*About 12 tons Upriver Fine Para Rubber at 2.42 per lb.
Equal monthly shipments January to June, 1911.*

CONDITIONS ON WHICH ABOVE ORDER IS GIVEN

Goods on this order must be delivered when specified. In case you cannot comply, advise us by return mail stating earliest date of delivery you can make, and await our further orders. The acceptance of this order which in any event you must promptly acknowledge will be considered by us as a guarantee on your part of prompt delivery within the specified time.

Terms F. O. B.

[Mr. Miller of Brunswick to Poel & Arnold, January 7, 1911.

We beg herewith to advise you that within the past few weeks there has come to our attention through a statement made to us for the first time by Mr. Rogers, information as to certain transactions had by him with you in the past, and especially as to a transaction in April last relating to 12 tons of crude rubber. Mr. Rogers had no authority to effect any such transaction on our account, nor had we any notice or knowledge of his action until he made a voluntary statement disclosing the facts within the past few weeks.

In order that you may not be put to any unnecessary inconvenience, we feel bound to give you notice at the earliest opportunity after investigating the facts, that we shall not recognize these transactions or any others that may have been entered into with Mr. Rogers which were without our knowledge or authority.

The first letter is of no legal significance, and only the other three need be considered. The fundamental question in this case is whether these writings constitute a contract between the parties. An analysis of their provisions will show that they do not constitute a contract. The plaintiffs' letter of April 4th is a mere offer or proposal by the plaintiffs that the defendant should accept the proposed contract enclosed which is said to embody an oral order that the defendant had that day given the plaintiffs. The letter of the defendant of April 6th did not accept this offer. If the

intention of the defendant had been to accept the offer made in the plaintiffs' letter of April 4th, it would have been a simple matter for the defendant to have indorsed its acceptance upon the proposed contract which the plaintiffs' letter of April 4th had enclosed. Instead of adopting this simple and obvious method of indicating an intent to accept the contract proposed by the plaintiffs the defendant submitted its own proposal and specified the terms and conditions upon which it should be accepted. The defendant's letter of April 6th was not an acceptance of this offer made by the plaintiffs in their letter of April 4th. It was a counter-offer or proposition for a contract. Its provisions make it perfectly clear that the defendant (1) asked the plaintiffs to deliver rubber of a certain quality and quantity at the price specified in designated shipments; (2) it specified that the order therein given was conditional upon the receipt of its order being promptly acknowledged, and (3) upon the further condition that the plaintiffs would guarantee delivery within the time specified. The plaintiffs did not acknowledge the receipt of this order and the proposal remained unaccepted.

As the party making this offer deemed this provision material and as the offer was made subject to compliance with it by the plaintiffs it is not for the court to say that it is immaterial. When the plaintiffs submitted this offer in their letter of April 4th to the defendant only one of two courses of action was open to the defendant. It could accept the offer made and thus manifest that assent which was essential to the creation of a contract or it could reject the offer. There was no middle course. If it did not accept the offer proposed it necessarily rejected it. A proposal to accept the offer if modified or an acceptance subject to other terms and conditions was equivalent to an absolute rejection of the offer made by the plaintiffs. *Mactier's Administrators v. Frith*, 6 Wend. 103 (N.Y. 1830); *Vassar v. Camp*, 11 N.Y. 441 (1854); *Chicago & G. E. Ry. Co. v. Dane*, 43 N.Y. 240 (1870); *Mahar v. Compton*, 45 N.Y.S. 1126 (Sup. Ct. App. Div. 1897); *Barrow Steamship Co. v. Mexican Central Ry. Co.*, 31 N.E. 261 (N.Y. 1892).

The respondent and the courts below, while recognizing this principle of the law of contracts, failed to give it effect upon the theory that the conditions expressed in the defendant's order of April 6th were not a part of the defendant's offer. In reference to these conditions printed upon the offer of the defendant of April 6th the learned trial justice held that "it was never the intention that the printed matter had any bearing whatsoever upon the transactions." The learned justice writing for the Appellate Division said that the clause embodying this condition "was not intended to call for an acceptance particularly in view of the former transaction between the parties."

The view of the trial justice that the printed matter was not intended to be a part of the contract rests upon his inference as to the intention of the parties. In the present case the printed clauses must be deemed to be a part of the order and cannot

be eliminated therefrom by the court upon an inference as to the intention of the parties which is not reflected in the order or in any evidence that was received upon the trial. The clause requiring a prompt acknowledgment by the plaintiffs of the defendant's offer as a condition to its acceptance was not in conflict with any of the provisions expressed in that offer either written or printed and must, therefore, be given effect. When the defendant's letter of April 6th is so considered it becomes evident that it did not constitute an acceptance of the offer of the plaintiffs, but was a new proposition for a contract upon the terms therein proposed.

The judgment appealed from should be reversed and a new trial granted, with costs to abide the event.

WILLARD BARTLETT, C.J., and HISCOCK, COLLIN, HOGAN, and CARDOZO, JJ., concur; POUND, J., dissents.

Review Question 4. Which of the pieces of correspondence described in this case qualified as offers? Why those and not any of the others? Defendant-buyer Brunswick's letter of April 6 seems, in many respects, like an acceptance of the deal proposed by plaintiff-seller Poel & Arnold on April 4. What specific language in the April 6 letter turns it into a counteroffer rather than an acceptance?

Review Question 5. Over the years, the *Poel* case has been criticized by many legal scholars. Why might they be concerned about the outcome of the case and the rules announced by the court? Can you see any possibility of abuse?

Review Question 6. As it happens, the outcome in *Poel* would likely be very different today because of changes made by the Uniform Commercial Code. You will run into the relevant provision, UCC § 2-207 later in these materials, but you might want to look at it now. What would change in the outcome?

Problems

Problem 5.1

Aunt Mary is a 90-year-old woman who lives in New Hampshire. Although she is still active, most of her friends are dead and she has very little family left. She is often lonely. She is visited by her great-nephew Earle, a college freshman who lives in Los Angeles. She likes Earle a great deal and they get along very well. During the course of his stay, just before he is to return home, she says, “Earle, I don’t have many people left, and there won’t be hardly anyone at my funeral. I’d like it if you’d be there. You’re my only family.”

“Oh, you’re not going to die for a long time, Aunt Mary,” says Earle.

“Not for a while, child,” she says, “but the Lord takes all of us. I want you to be there.”

“Aunt Mary, I refuse to talk about such morbid stuff. You’re going to outlive me.”

She laughs and shakes her head. “Here’s what I want to tell you. If you come to my funeral, I’ll pay for your ticket to get here, and all your expenses, and I’ll give you \$1,000.”

“Now Aunt—”

“Don’t interrupt me. You don’t have to answer now. Just be there. If you come, wherever I am, I’ll know it. “

Three years later, Earle is notified of Aunt Mary’s death. Although it is the middle of the semester and very inconvenient, he remembers how much it meant to her, flies to New Hampshire for the funeral. The cost of the ticket and the hotel are substantial, and strain his credit to the maximum. After the funeral, he asks the executor of her will for the payment, claiming there is a contract. The executor refuses. There is no mention of this in Aunt Mary’s will, which leaves all of her meager wealth to a local animal shelter.

If Earle sues Aunt Mary’s estate, what result? Why?

Problem 5.2

Antique Dealer has a mint condition, in-the-box, never opened Stinky Pete the Prospector doll from the popular 1950s television show, *Woody’s Roundup*. Collector, who is a big fan of the show, contacts Dealer to inquire about buying the doll. The two negotiate by telephone, but do not come to an agreement. The next day—Tuesday—Dealer sends the following signed message to Collector: “I offer to sell you the Stinky Pete doll for \$3,750 cash. I will leave this offer open until Friday.” Collector gets the message. On Wednesday, Collector calls Dealer to accept, but before he can do more

than identify himself, Dealer says, “Sorry, I sold the Stinky Pete doll yesterday. I don’t have it any more, so I can’t sell it to you.” Collector is unhappy and hangs up.

The next morning, however, Collector learns that Dealer had not in fact sold the doll, and still has it. Dealer had simply decided not to sell because he heard that the wealthy Konishi Toy Museum in Tokyo might be interested. When he learns this fact Collector calls Dealer. When Dealer answers, Collector says, “I’m calling to accept your offer. I know you still have it, and you promised the offer would be open until tomorrow. I’m buying it.” Dealer refuses to sell, however, and ultimately sells the doll to Konishi for \$10,000. Collector sues to enforce what he claims is an enforceable contract to buy Stinky Pete. What will both sides argue? What result and why?

Problem 5.3

Truong is a supplier of fresh fish and other seafood to supermarkets in the Gulf of Mexico region. On a Tuesday in late July, he sends a truckload shipment of fresh jumbo Gulf shrimp from his facility in Corpus Christi, Texas, to United Stores in El Paso. When the truck reaches El Paso—where the temperature is 110 degrees Fahrenheit—United refuses to accept the shipment, saying that it had not placed the order. As the truck sits at the United loading dock, its refrigeration units stop working. The driver calls Truong, who realizes that he has a truckload of fresh shrimp that will soon become boiled shrimp in the El Paso heat. He tries to call Vera, a competitor of United, on her cell phone, but gets her voicemail. He leaves her a quick message, saying “I’ve got 5,000 pounds of fresh jumbo shrimp—the kind you usually buy from me—on a truck there in El Paso. I don’t want to have to bring it back, so I can let you have the whole load for \$5,000. That’s half price, just because I’ve already got it there, and this deal is for you because you’re a great customer. I’ve got to know soon, though.” He then sends Vera a text message repeating essentially what he said on the phone. Unknown to Truong, however, Vera is on a plane inbound to El Paso and her phone is set to airplane mode.

Truong does not hear back from Vera for 45 minutes. Worried that the shrimp will spoil, he calls Bernie, another buyer. Bernie answers, Truong makes the same offer, which Bernie accepts immediately. Truong calls his driver, who immediately sets off for Bernie’s warehouse. Five minutes later, Vera’s plane lands and she turns on her phone. Getting Truong’s message, she immediately texts an acceptance. She subsequently learns that Truong sold the shrimp to her competitor, Bernie.

Vera claims that her text in response to Truong’s offer created a contract. If she sues, what result and why? Consider both sides’ arguments on this question.

Unit 6: Acceptance

CONTRACT FORMATION Part Four

FOCUS OF THIS UNIT

You should now know what qualifies as an offer and when an offer terminates. The next question in contract formation is whether an open offer has been accepted. So what exactly do we mean when we talk about contractual “acceptance”?

Offer Controls Acceptance. When we say that the offeror is “master of the offer,” we mean that the offeror gets to define how the offer must be accepted. For example, suppose the authors approached you and said, “We will pay you \$20 if you will stand up on one leg in the middle of your Property class, flap your arms like a bird, and recite the first paragraph of the Preamble to the *Communist Manifesto*. We don’t want your promise; we’ll pay you only if you *actually do it*.”¹ Based on that offer, then the *only* way you can accept it is by doing exactly what we said. If you say, “I accept,” you haven’t, in fact, accepted, because we clearly told you that we didn’t want your acceptance. There is no contract. You are not obliged to do anything at that point, and we are free to revoke our offer. If, in fact, you stand on both legs, or you recite the Preamble to the United States Constitution, you have not accepted the offer. Being “master of the offer” simply means that the offeror has the power to specify exactly how an offer can be accepted.

Notice that while our definition of an “offer” does take into account whether the offeree reasonably believes there is *an offer*, we do not concern ourselves with whether he believes he has *accepted*. Instead, to accomplish the latter, the offeree must do what the offeror says. Intent is not usually the key. This point may seem obvious, but problems arise from the fact that in the real world—the world in which contract law must actually operate—people are not necessarily precise about what they want or what they are doing. Ordinary people rarely recite, “I hereby accept your offer.” More often, they nod, shake hands, exchange emails, or simply start doing what the offeror asked. They also don’t necessarily say the word “accept” while

¹ [We have been advised by our counsel to clearly say “Just kidding!” at this point to prevent you from suing us for twenty dollars after you embarrass yourself and annoy your Property professor. *But see Leonard v. PepsiCo* (holding that an over-the-top joke did not constitute an offer) – Eds.]

functionally accepting an offer. The fact that regular human beings don't necessarily do what lawyers (or law students) would do leads to the question of when a particular communication counts as an "acceptance."

Keep in mind that the existence or non-existence of an "acceptance" can have important legal consequences for an analysis of whether a contract exists under the common law. If an offeree's response actually qualifies as an "acceptance," then we may have an enforceable contract (subject, of course, to a host of other issues we are covering in this course). If the offeree's response to an offer is anything *other than an* "acceptance," then no contract has been formed.

Under the common law of contracts, acceptance must match the offer. The match must be so complete that the concept is sometimes referred to as the "mirror image rule." Acceptance does not, however, require the offeree to recite a magic formula, like "I hereby accept the offer as stated," as that would throw a wrench into business transactions and make contracting so hyper-technical as to be nearly useless for real life. A mirror-image acceptance can happen in any number of ways. This unit deals with a few situations that have caused particular difficulties in analyzing whether an offer-and-acceptance has occurred.

Three Problems to Watch. The first arises from the fact that some situations are entirely clear as to who is offeror and who is offeree. You have seen that an advertisement is (usually) not an offer, and that it is the buyer who technically is the offeror even where the seller's advertisement is the initial solicitation to enter a contract. Thus, doing something that the average non-lawyer might consider as acceptance of an offer, such as ordering merchandise from a catalog, is actually the offer itself. Exactly who is who in certain transactions can actually be complicated.

A second problem occurs when what the offeror is seeking is not entirely clear. Is the offeror asking a party to *do* something (such as performing a task), or to *say* something in the form of a promise? The distinction becomes important in what traditionally are called *unilateral* and *bilateral* contracts. You have seen those terms before by now, but make sure in the readings below that you can understand both the difference and the consequence of that difference for purposes of contract formation. You should also be aware that the Restatement (Second) of Contracts dropped the unilateral-bilateral distinction and terminology—*see, e.g.*, section 30—though it lives on in many cases, treatises, and bar exam questions.

A third area of confusion is the issue of acceptance by silence. Could, for example, an offeror say, "I offer to sell you my car for \$5,500, and unless I receive a written rejection from you within 24 hours, you will have accepted my offer.?" (Actually, we know the offeror *could* say such a thing, so our real concern is whether that offer could form a contract by the offeree's inaction.) In other words, are there situations in which mere *silence* on the part of the offeree is enough to create a contract?

Of Mailboxes and Inboxes. Another twist that we should highlight here briefly—if only because it has been the bane of law students for generations—is the so-called *mailbox rule*. You will come across the mailbox rule in the case of *United States Life Insurance Co. v. Wilson*, later in this unit. For the moment, just know that it is an important variant of when an acceptance is effective to create a contract. You will learn more when you read the *Wilson* case.

One additional note: In the following materials we are considering the common law of contracts as generally observed in the United States. Later, you will see that these rules may or may not be the same when specific kinds of contracts governed by statutes and treaties.

Cases and Materials

DAVIS v. JACOBY

Supreme Court of California
1 Cal. 2d 370, 34 P.2d 1026 (1934)

THE COURT IN BANK.

[Rupert and Blanche Whitehead were a wealthy California couple without children. Caro Davis was Blanche's niece, and was very close to the Whiteheads, often being treated as their "daughter." Caro had lived with them until her marriage to Frank Davis—which was held in the Whitehead home—in 1913. The Davises moved to Canada, but stayed very close. In 1930 Blanche became very ill, and Rupert's financial affairs were made precarious by the onset of the depression. By 1931 Rupert needed help with his hospitalized wife and with his deteriorating finances. In late March and April, 1931, he wrote letters to Caro and Frank, pleading for them to come and stay with him and help him. Then, on April 12, he wrote again, noting that Blanche "cannot last much longer," and that his affairs were "not as bad as I supposed at first." He listed various properties and estimated that \$150,000 could be "saved from the wreck." He continued:

[M]y trouble was caused by my friends taking advantage of my illness and my position to skin me. Now if Frank could come out here and be with me, and look after my affairs, we could easily save the balance I mentioned, provided I don't get into another panic and do some more foolish things.

The next attack will be my end, I am 65 and my health has been bad for years, so, the Drs. don't give me much longer to live. So if you can come,

Caro will inherit everything and you will make our lives happier and see Blanche is provided for to the end.

My eyesight has gone back on me. I can't read only for a few lines at a time. I am at the house alone with Stanley [the chauffeur] who does everything for me and is a fine fellow. Now, what I want is someone who will take charge of my affairs and see I don't lose any more. Frank can do it, if he will and cut out the booze.

Will you let me hear from you as soon as possible, I know it will be a sacrifice but times are still bad and likely to be, so by settling down you can help me and Blanche and gain in the end. If I had you here my mind would get better and my courage return, and we could work things out.

Frank immediately wrote back saying that he accepted Rupert's proposition and that he and Caro would come to California and be there on April 25. Rupert acknowledged the letter. Before they left Canada, however, Rupert killed himself on April 22. The Davises nevertheless came to California and cared for Blanche until her own death on May 30. It turned out that Rupert had left his wife only a life estate in the property, had not provided for the Davises, and had instead left the entire estate to his own nephews. The Davises sued, claiming that the promise that "Caro Davis would inherit everything" was a contractual offer which they had accepted by mail, and that Caro was therefore entitled to the estate. The trial court ruled against them.]

The theory of the trial court and of respondents on this appeal is that the letter of April 12th was an offer to contract, but that such offer could only be accepted by performance and could not be accepted by a promise to perform, and that said offer was revoked by the death of Mr. Whitehead before performance. In other words, it is contended that the offer was an offer to enter into a unilateral contract, and that the purported acceptance of April 14th was of no legal effect.

(1) The distinction between unilateral and bilateral contracts is well settled in the law. It is well stated in section 12 of the American [Law] Institute's Restatement of the Law of Contracts² as follows:

A unilateral contract is one in which no promisor receives a promise as consideration for his promise. A bilateral contract is one in which there are mutual promises between two parties to the contract; each party being both a promisor and a promisee.

This definition is in accord with the law of California. *Christman v. Southern Cal. Edison Co.*, 256 P. 618 (Cal. Ct. App. 1927).

² [This is a reference the first Restatement, published in 1932, which maintained use of the bilateral-unilateral terminology. – Eds.]

In the case of unilateral contracts no notice of acceptance by performance is required. Section 1584 of the Civil Code provides, "Performance of the conditions of a proposal, . . . is an acceptance of the proposal." See *Cuthill v. Peabody*, 125 P. 926 (Cal. Ct. App. 1912); *Los Angeles Traction Co. v. Wilshire*, 67 P. 1086 (Cal. 1902).

(2) Although the legal distinction between unilateral and bilateral contracts is thus well settled, the difficulty in any particular case is to determine whether the particular offer is one to enter into a bilateral or unilateral contract. Some cases are quite clear cut. Thus an offer to sell which is accepted is clearly a bilateral contract, while an offer of a reward is a clear-cut offer of a unilateral contract which cannot be accepted by a promise to perform, but only by performance. *Berthiaume v. Doe*, 133 P. 515 (Cal. Ct. App. 1913). Between these two extremes is a vague field where the particular contract may be unilateral or bilateral depending upon the intent of the offeror and the facts and circumstances of each case. The offer to contract involved in this case falls within this category. By the provisions of the Restatement of the Law of Contracts it is expressly provided that there is a presumption that the offer is to enter into a bilateral contract. Section 31 provides:

In a case of doubt it is presumed that an offer invites the formation of a bilateral contract by an acceptance amounting in effect to a promise by the offeree to perform what the offer requests, rather than the formation of one or more unilateral contracts by actual performance on the part of the offeree.

Professor Williston in his *Treatise on Contracts*, volume 1, section 60, also takes the position that a presumption in favor of bilateral contracts exists.

In the comment following section 31 of the Restatement the reason for such presumption is stated as follows:

It is not always easy to determine whether an offeror requests an act or a promise to do the act. As a bilateral contract immediately and fully protects both parties, the interpretation is favored that a bilateral contract is proposed.

While the California cases have never expressly held that a presumption in favor of bilateral contracts exists, the cases clearly indicate a tendency to treat offers as offers of bilateral rather than of unilateral contracts.

(3) Keeping these principles in mind we are of the opinion that the offer of April 12th was an offer to enter into a bilateral as distinguished from a unilateral contract. Respondents argue that Mr. Whitehead had the right as offeror to designate his offer as either unilateral or bilateral. That is undoubtedly the law. It is then argued that from all the facts and circumstances it must be implied that what Whitehead wanted was performance and not a mere promise to perform. We think this is a *non sequitur*, in fact the surrounding circumstances lead to just the opposite conclusion. These

parties were not dealing at arm's length. Not only were they related, but a very close and intimate friendship existed between them. The record indisputably demonstrates that Mr. Whitehead had confidence in Mr. and Mrs. Davis, in fact that he had lost all confidence in everyone else. The record amply shows that by an accumulation of occurrences Mr. Whitehead had become desperate, and that what he wanted was the promise of appellants that he could look to them for assistance. He knew from his past relationship with appellants that if they gave their promise to perform he could rely upon them. The correspondence between them indicates how desperately he desired this assurance. Under these circumstances he wrote his offer of April 12th, above quoted, in which he stated, after disclosing his desperate mental and physical condition, and after setting forth the terms of his offer: "Will you let me hear from you as soon as possible—I know it will be a sacrifice but times are still bad and likely to be, so by settling down you can help me and Blanche and gain in the end." By thus specifically requesting an immediate reply Whitehead expressly indicated the nature of the acceptance desired by him—namely, appellants' promise that they would come to California and do the things requested by him. This promise was immediately sent by appellants upon receipt of the offer, and was received by Whitehead. It is elementary that when an offer has indicated the mode and means of acceptance, an acceptance in accordance with that mode or means is binding on the offeror.

Another factor which indicates that Whitehead must have contemplated a bilateral rather than a unilateral contract, is that the contract required Mr. and Mrs. Davis to perform services until the death of both Mr. and Mrs. Whitehead. It is obvious that if Mr. Whitehead died first some of these services were to be performed after his death, so that he would have to rely on the promise of appellants to perform these services. It is also of some evidentiary force that Whitehead received the letter of acceptance and acquiesced in that means of acceptance.

(4) For the foregoing reasons we are of the opinion that the offer of April 12, 1931, was an offer to enter into a bilateral contract which was accepted by the letter of April 14, 1931. Subsequently appellants fully performed their part of the contract. Under such circumstances it is well settled that damages are insufficient and specific performance will be granted.

For the foregoing reasons the judgment appealed from is reversed.

Review Question 1. The court draws a distinction between acceptance by promise and acceptance by performance. Review sections 50-56 of the Restatement (Second) of Contracts, which deal with issues addressed in *Davis* but do not use the same terminology. Make an outline explaining how those various provisions work together, and see if you notice the concepts of unilateral and bilateral contracts, despite the fact that those terms are not used.

Review Question 2. Pretend that you are the judge for a case with the exact same facts as *Davis v. Jacoby*, except that your jurisdiction has adopted the rules contained in sections 30 and 32 of the Restatement (Second) of Contracts. How would you decide that case? Would reaching a decision be harder or easier than it was for the *Davis* court following the first Restatement?

HENDRICKS v. BEHEE

Court of Appeals of Missouri, Southern District
786 S.W.2d 610 (Mo. Ct. App. 1990)

FLANIGAN, J.

After Behee, as prospective buyer [of a home owned by the Smiths], and the Smiths, as prospective sellers, had engaged in unproductive negotiations, Behee, on March 2, 1987, made a written offer of \$42,500 for the real estate and \$250 for a dinner bell and flower pots. On March 3 that offer was mailed to the Smiths, who lived in Mississippi, by their real estate agent.

On March 4 the Smiths signed the proposed agreement in Mississippi. Before Behee was notified that the Smiths had accepted the offer, Behee withdrew the offer by notifying the real estate agent of the withdrawal. That paramount fact is conceded by this statement in the Smiths' brief: "On either March 5, 6 or 7, 1987, Behee contacted [the Smiths' real estate agent] and advised her that he desired to withdraw his offer to purchase the real estate. Prior to this communication, Behee had received no notice that his offer had been accepted by the Smiths."

There is no contract until acceptance of an offer is communicated to the offeror. *ACF Industries, Inc. v. Industrial Commission*, 320 S.W.2d 484, 492 (Mo. *en banc* 1959); 17 AM. JUR. 2d *Contracts* § 43, p. 380; 17 C.J.S. *Contracts* § 45, p. 690.

An uncommunicated intention to accept an offer is not an acceptance. When an offer calls for a promise, as distinguished from an act, on the part of the offeree, notice of acceptance is always essential. A mere private act of the offeree does not constitute an acceptance. Communication of acceptance of a contract to an agent of the offeree is not sufficient and does not bind the offeror.

Unless the offer is supported by consideration, an offeror may withdraw his offer at any time "before acceptance and communication of that fact to him." To be effective, revocation of an offer must be communicated to the offeree before he has accepted.

Notice to the agent, within the scope of the agent's authority, is notice to the principal, and the agent's knowledge is binding on the principal.

Before Behee was notified that the Smiths had accepted his offer, Behee notified the agent of the Smiths that Behee was withdrawing the offer. The notice to the agent, being within the scope of her authority, was binding upon the Smiths. Behee's offer was not supported by consideration and his withdrawal of it was proper.

The judgment is affirmed.

Review Question 3. We told you previously that the offeror is master of the offer. Imagine you represent a client who just received an offer to sell her a piece of real estate, and she is interested but not yet sure. Based on *Hendricks*, what sort of things would you look for in the text of the offer so that you can advise your client on what she must do to ensure the formation of a contract?

Review Question 4. Was the offeror in *Hendricks* seeking a return promise, a performance, or either? If the offeror sought a promise, consider this language from section 50(3) of the Restatement (Second) of Contracts: "Acceptance by a promise requires that the offeree complete every act essential to the making of the promise." Does that definition support the court's conclusion? Why or why not?

UNITED STATES LIFE INSURANCE CO. v. WILSON

Court of Special Appeals of Maryland
198 Md. App. 452, 18 A.3d 110 (2011)

DEBORAH S. EYLER, J.

The principal issue in this case is whether a policy of insurance on the life of John G. Griffith, M.D., was in force the day he died. We hold that it was. In the Circuit Court for Baltimore City, Elizabeth Wilson, Dr. Griffith's widow and the appellee, filed a breach of contract action against the United States Life Insurance Company, and AMA Insurance Agency, Inc. ("AMAIA"), the appellants, claiming they had failed to pay the death benefit and accidental death benefit on a policy insuring Dr. Griffith's life ("the Policy"). The appellants maintained that the Policy no longer was in force when Dr. Griffith died. Ms. Wilson acknowledged that the Policy had lapsed but maintained that it had been reinstated before Dr. Griffith died. The court agreed with Ms. Wilson and granted summary judgment in her favor.

Effective November 15, 1998, Dr. Griffith purchased an "American Medical Association-Sponsored Group Level Term Life Insurance Policy," Certificate Number 9500108167, which was underwritten by US Life. The Policy was for a 10-year term. Dr. Griffith was the owner of the Policy and was the named insured. Ms. Wilson was the primary beneficiary. Under the Policy, if Dr. Griffith died "while this [life]

insurance is in force,” then, upon presentation of proof of his death to US Life, US Life would pay the beneficiary the scheduled benefit. The scheduled benefit for death was \$400,000, with an additional accidental death benefit of \$250,000.

Dr. Griffith purchased the Policy through AMAIA, a subsidiary of the American Medical Association. AMAIA acted as the third-party administrator for US Life, meaning that, with respect to US Life policies, including this Policy, it was responsible for, among other things, billing and collecting premiums. AMAIA was authorized to receive premium payments on the Policy.

The Policy contained the following PREMIUM PAYMENTS provision:

Premiums will be due annually, or at another agreed upon frequency, as long as you remain eligible for insurance. Payment can be made to United States Life at United States Life’s Home Office or to our authorized agent. Payment of any premium will not maintain insurance in force past the next premium due date, except as provided in the Grace Period provision.

The Policy GRACE PERIOD provision, as referenced in the PREMIUM PAYMENTS clause, read as follows:

Each premium, after the first, may be paid up to 31 days after its due date. This period is the grace period. The insurance provided by the group policy will stay in effect during this period. If the premium is not paid by the end of this period, such insurance will end at that time.

United States Life may extend the grace period by written notice. Such notice will state the date insurance will end if the premium remains unpaid.

Premiums must be paid for a grace period and any extension of such period.

The Policy further contained a REINSTATEMENT clause detailing how coverage could be reinstated after a lapse:

If the coverage ceases as provided in the Grace Period provision, you may reinstate it. Reinstatement must be made within 90 days after the due date of the first unpaid premium.

Such reinstatement is subject to:

1. Payment of all overdue premiums; and
2. Written approval by United States Life of the required evidence of insurability. However, such evidence will not be required within 31 days after the end of the Grace Period.

Dr. Griffith made his semi-annual premium payments from 1998 through 2006. Before his May 15, 2007 premium came due, AMAIA sent him an undated BILL NOTICE reminding him of the upcoming payment due date. During that period of time, Dr. Griffith was obtaining quotes from other life insurance companies for similar coverage, with the apparent purpose of changing insurers. Dr. Griffith failed to pay the May 15, 2007 Policy premium. After he missed the payment, AMAIA sent him an undated REMINDER NOTICE, stating: “To assure active coverage, full payment of the premium must be received no later than 60 days from the due date.” The due date was again listed as May 15, 2007.

Until Monday, July 23, 2007, Dr. Griffith still had not taken any steps to pay the overdue May 15, 2007 premium. That day, he accessed by computer his on-line bank account with Bank of America and electronically directed that a premium payment of \$369.46 be made to AMAIA. Bank of America documents in the summary judgment record show that a check for that amount “was sent to AMA Insurance Agency on [Wednesday] 07/25/07 and delivered on [Monday] 07/30/07.”

On Saturday, July 28, 2007, Dr. Griffith, Ms. Wilson, and their children were on vacation in Bethany Beach, Delaware. Dr. Griffith went on an early morning bike ride. He was kneeling beside his bicycle on the shoulder of State Route 1 at 7:40 a.m. when he was struck and killed by a car that drifted off the road when its driver fell asleep at the wheel. Dr. Griffith was 44 years old when he died.

AMAIA received Dr. Griffith’s premium check on July 30, 2007. On August 2, 2007, AMAIA rejected the payment and returned the check enclosed in a letter advising that, because Dr. Griffith’s “payment was received after the closing of the 30-day grace period,” he no longer could renew his insurance coverage simply by making the premium payment. Instead, he could apply for reinstatement of coverage by completing and returning an APPLICATION FOR REINSTATEMENT OF COVERAGE, although approval was not guaranteed. When the August 2, 2007 letter was sent, AMAIA had no information that Dr. Griffith had died.

On September 28, 2007, Ms. Wilson, through counsel, submitted a claim to AMAIA for the death benefit and accidental death benefit under the Policy. AMAIA denied her claim by letter of April 14, 2008, stating that the Policy had lapsed on May 15, 2007, and therefore was not in force when Dr. Griffith died.

[The court examines the various documents and communications involved. It concludes that US Life had extended the grace period to 60 days, which meant it had expired on July 14. The court held that Dr. Griffith had 30 days from that date (not later than August 13) to, in effect, accept US Life’s offer to reinstate the policy, and he had to be alive at the time of acceptance. Ms. Walker argued that the offer was accepted as of the date the check was sent (July 25), while US Life argued that it was not accepted, if at all, until at least July 30, when the check arrived. Dr. Griffith died on July 28.]

The language of the Policy itself, not the language in the notices, controlled the means to effect reinstatement. The relevant language of the REINSTATEMENT clause is, “reinstatement is subject to: 1. Payment of all overdue premiums.”

Insurance contracts initially are formed when an insurer unconditionally accepts an insured’s application, which constitutes an offer, for coverage. *Martin v. Government Employees Ins. Co.*, 206 Ill. App. 3d 1031, 1039-40, 565 N.E.2d 197 (Ill. App. Ct. 1990). From then on, the life insurance policy operates as a unilateral contract, 29 APPLEMAN ON INSURANCE 2D § 179.03, AT 230 (JEFFREY E. THOMAS ED. 2006), i.e., one that is formed by performance. See 1 WILLISTON ON CONTRACTS § 4:8, AT 462 (4TH ED., RICHARD A. LORD, 2007) (observing that a unilateral contract is one in which one party makes a promise and the other party renders an act or forbearance). “The periodic payment of premiums is the mechanism by which the insured opts to keep the insurance policy in force.” APPLEMAN, *supra*, § 179.0-3, at 230. Failure to pay the premiums will result in coverage lapsing.

Under the policy, when the relevant time frame for reinstatement is “within 31 days after the end of the Grace Period” (as it is here), the REINSTATEMENT clause is a promise by the insurer to reinstate coverage upon performance by the insured of a single act—payment of the overdue premium. In that situation, the insurer is not being asked to consider and either accept or reject an offer by the insured to enter into a life insurance contract. Thus, the plain language of the REINSTATEMENT clause of the Policy establishes that, upon payment by the insured of the overdue premium within 31 days after the end of the grace period, the Policy is revived. In other words, in that situation, the REINSTATEMENT clause is an offer of a unilateral contract to revive the Policy, with the insurer promising that revival will take place upon the insured’s performing by paying the overdue premium.

It is within the context of Dr. Griffith’s acceptance by performance (that is, by payment of the overdue premium) of US Life’s offer to revive the Policy that we must determine when payment took place. At common law, what is often called the “mailbox rule,” the “dispatch rule,” or sometimes the “postal acceptance rule” is the widely-adopted convention for pinpointing the time that an offer is accepted and a contract is formed. Illinois, like Maryland, recognizes the rule, by which “the mailed acceptance of an offer is effective when mailed, not when received or acknowledged.” *Martin*, 565 N.E.2d at 203. See also *Wagner v. McClay*, 138 N.E. 164 (Ill. 1923) (recognizing that a letter of acceptance of a contract that is properly deposited in the mail makes the acceptance binding); *Cochran v. Norkunas*, 919 A.2d 700 (Md. 2007) (“The well established rule is that in the absence of any limitation or provision to the contrary in the offer, the acceptance of the offer is complete and the contract becomes binding on both parties when the offeree deposits the acceptance in the post box.”).

Section 63(a) of the Restatement (Second) of Contracts (1979), while not using any of the familiar mailbox rule nomenclature, recognizes with respect to the time

that acceptance of an offer takes effect hat, unless an offer states otherwise, “an acceptance made in a manner and by a medium invited by the offer is operative and completes the manifestation of mutual assent as soon as put out of the offeree’s possession, without regard to whether it ever reaches the offeror.” The rationale for the rule, as explained in comment (a) to that subsection, is, essentially, certainty and predictability. The comment observes that, even though it may be possible under United States postal regulations for a sender to stop delivery and reclaim a letter, it remains the case that one to whom an offer has been made “needs a dependable basis for his decision whether to accept,” and has such a basis when he knows that, once properly dispatched, his acceptance is binding and the offer cannot be revoked.

In 2 WILLISTON ON CONTRACTS §6:32 (4TH ED. RICHARD A. LORD, 2007), the author explains that the “dispatch rule” applies equally to bilateral and unilateral contracts. If an offer for a unilateral contract calls for the performance of an act by the offeree that can be accomplished by sending money through the mail, including in the form of a check, “as soon as the money is sent it would become the property of the offeror, and the offeror would become bound to perform its promise for which the money was the consideration.” *Id.* at 441-42. *See, e.g., Hagerl v. Auto Club Group Ins. Co.*, 403 N.W.2d 197 (Mich. Ct. App. 1987) (holding that an offer to renew an automobile liability insurance policy was accepted by the insured by mailing his check, even though the check subsequently was dishonored).

We conclude that the long-recognized mailbox rule governing the time of formation of a contract by written acceptance applies in the case at bar to control the time the Policy was reinstated, that is, when coverage under the Policy was revived. The transaction at issue here is not wholly traditional, that is, one in which a paper document, whether a check or otherwise, is mailed by the offeree to the offeror, in that it began electronically, as an on-line banking directive by Dr. Griffith on July 23, 2007. The Bank of America documents in the summary judgment record show, however, that the directive was acted upon by preparation of a paper check drawn on a JP Morgan Chase Bank, N.A. account under Dr. Griffith’s name, and bearing his “Authorized Signature”; and that the paper check then was “sent” to AMAIA on July 25, 2007, coming into AMAIA’s physical possession on July 30, 2007.

The transaction thus resembles a traditional acceptance by writing mailed to the offeror, in that a writing (the check) was “sent” to AMAIA, even though its creation was directed electronically and it was created not by the offeree but by his bank. A writing thus was generated by actions taken by Dr. Griffith; the writing complied with that which was necessary to accept the reinstatement offer; and the writing was “sent,” which was a permissible mode of acceptance, and subsequently was delivered to AMAIA, the proper recipient.

Application of the mailbox rule to the undisputed material facts in this case produces the legal conclusion that the date of payment of the overdue premium was July 25, 2007. On July 23, 2007, Dr. Griffith electronically instructed Bank of

America, as his agent, to make payment to AMAIA. The evidence viewed most favorably to the appellants supports a reasonable inference that Dr. Griffith could have reinstructed Bank of America not to make the payment; therefore, as of July 23, 2007, he had set in motion the means to accept the offer of reinstatement but still had the power to reverse course. On July 25, 2007, however, Bank of America remitted payment to AMAIA by sending it a check, drawn on the J. P. Morgan Chase Bank, N.A. account, for \$369.46. At that point, the permissible means for acceptance was in motion and, so far as is established by the common law mailbox rule, was beyond Dr. Griffith's power to stop. This would be true whether Bank of America sent the check through the United States Postal Service, a courier service, or otherwise.

For all these reasons, we hold that the Policy was reinstated effective July 25, 2007, three days before Dr. Griffith died, and therefore was in force when he died. It was undisputed that Dr. Griffith's death was an accident under the terms of the Policy. The circuit court therefore properly entered judgment in favor of Ms. Wilson against US Life for \$650,000, plus pre-judgment interest.

Review Question 5. The *U.S. Life Insurance* court says that, by the time of the dispute in this case, the insurance contract was a “unilateral contract.” What are the implications for formation (or re-formation) of the contract in this case of it being unilateral? Was Dr. Griffith's insurance policy *originally* a unilateral contract? Why or why not?

Review Question 6. In *Hendricks v. Behee*, which you read earlier in this unit, the court held that acceptance had to be communicated to the offeror. Can you reconcile that with the “mailbox rule” in this case?

Review Question 7. In the modern world, the post office is used less and less as a medium of communication in making contracts. Would the rationale of the mailbox rule apply to an email, voicemail, or text response? Is it effective when it is sent or when it is received? As you answer this question, consider section 15 of the Uniform Electronic Transactions Act, which is entitled “Time and Place of Sending and Receipt.” How—if at all—do the mailbox rule and UETA section 15 work together?

HOBBS v. MASSASOIT WHIP CO.
Supreme Judicial Court of Massachusetts
158 Mass. 194, 33 N.E. 495 (1893)

Contract, upon an account annexed for \$108.50, for 2,350 eelskins sold by the plaintiff to the defendant.

The plaintiff testified that he delivered the skins in question to one Harding of Lynn, on February 18, 1890, who upon the same or the following day forwarded them to the defendant; that the skins were in good condition when received by Harding, 2,050 of them being over twenty-seven inches in length each, and the balance over twenty-two inches in length each; that he had forwarded eelskins to the defendant through said Harding several different times in 1888 and 1889, and received payment therefor from the defendant; that he knew the defendant used such skins in its business in the manufacture of whips; that the skins sent on February 18, 1890, were for such use; that he understood that all skins sent by him were to be in good condition and over twenty-two inches in length, and that the defendant had never ordered of him skins less than twenty-two inches in length; and that Harding took charge of the skins for him and that he received orders through Harding.

Four letters were offered in evidence, three of which, dated in 1889, showed transactions between the plaintiff and the defendant, and the fourth of which, dated Lynn, February 18, 1890, signed by Harding and addressed to the defendant, was as follows: "We send you to-day, for Mr. Hobbs, 2,050 eelskins at .05 and 300 at .02."

One Pirnie, president of the defendant corporation, called by the defendant, testified that before February 18, 1890, the plaintiff had sent eelskins four or five times by Harding to the defendant, which were received and paid for by the defendant; that the defendant agreed to pay five cents each for eelskins over twenty-seven inches in length, and two cents each for eelskins over twenty-two inches in length and less than twenty-seven inches, suitable for use in the defendant's business; that the defendant never ordered the skins in question, and did not purchase them in any manner, and that no officer or employee of the corporation except himself had authority to order or purchase skins, and that he never ordered or purchased those in question.

The judge, among other instructions, also gave the following:

Whether there was any prior contract or not, if skins are sent to them (the defendants) and they see fit, whether they have agreed to take them or not, to lie back and say nothing, having reason to suppose that the man who has sent them believes that they are taking them, since they say nothing about it, then, if they fail to notify, you would be warranted in finding for the plaintiff, on that state of things.

The jury returned a verdict for the plaintiff; and the defendant alleged exceptions.

O.W. HOLMES, Jr., J.: This is an action for the price of eelskins sent by the plaintiff to the defendant, and kept by the defendant some months, until they were destroyed. It must be taken that the plaintiff received no notice that the defendants declined to accept the skins. The case comes before us on exceptions to an instruction to the jury, that, whether there was any prior contract or not, if skins are sent to the defendant, and it sees fit, whether it has agreed to take them or not, to lie back, and to say nothing, having reason to suppose that the man who has sent them believes that it is taking them, since it says nothing about it, then, if it fails to notify, the jury would be warranted in finding for the plaintiff.

Standing alone, and unexplained, this proposition might seem to imply that one stranger may impose a duty upon another, and make him a purchaser, in spite of himself, by sending goods to him, unless he will take the trouble, and be at the expense of notifying the sender that he will not buy. The case was argued for the defendant on that interpretation. But, in view of the evidence, we do not understand that to have been the meaning of the judge, and we do not think that the jury can have understood that to have been his meaning. The plaintiff was not a stranger to the defendant, even if there was no contract between them. He had sent eelskins in the same way four or five times before, and they had been accepted and paid for. On the defendant's testimony, it is fair to assume that, if it had admitted the eelskins to be over twenty-two inches in length, and fit for its business, as the plaintiff testified, and the jury found that they were, it would have accepted them; that this was understood by the plaintiff; and, indeed, that there was a standing offer to him for such skins. In such a condition of things, the plaintiff was warranted in sending the defendant skins conforming to the requirements, and even if the offer was not such that the contract was made as soon as skins corresponding to its terms were sent, sending them did impose on the defendant a duty to act about them; and silence on its part, coupled with a retention of the skins for an unreasonable time, might be found by the jury to warrant the plaintiff in assuming that they were accepted, and thus to amount to an acceptance. *See Bushel v. Wheeler*, 15 Q. B. 442; JUDAH P. BENJAMIN, TREATISE ON THE LAW OF SALE OF PERSONAL PROPERTY §§ 162-164 (3d ed. 1888); *Taylor v. Dexter Engine Co.* 146 Mass. 613, 615 (1888). The proposition stands on the general principle that conduct which imports acceptance or assent is acceptance or assent in the view of the law, whatever may have been the actual state of mind of the party—a principle sometimes lost sight of in the cases.

Exceptions overruled.

Review Question 8. “Standing alone, and unexplained,” says Justice Holmes, allowing for acceptance of a contract by silence “might seem to imply that one stranger may impose a duty upon another, and make him a purchaser, in spite of

himself, by sending goods to him” unsolicited. Isn’t that exactly what happened to the Massasoit Whip Company, as it was unwillingly forced into a contract? Why doesn’t Holmes seem to be worried about silence-as-acceptance encouraging a hoard of overzealous sellers to force unwilling customers into contracts by sending unsolicited products?

MUNICIPAL CONSULTANTS & PUBLISHERS, INC. v. TOWN OF RAMAPO

Court of Appeals of New York

47 N.Y.2d 144, 390 N.E.2d 1143, 417 N.Y.S.2d 218 (1979)

GABRIELLI, J.

The issue in this case is whether the Town of Ramapo is contractually obligated to receive and pay for the services offered by the petitioner Municipal Consultants & Publishers, Inc. (Municipal). For the reasons which follow we conclude that there existed an enforceable contract between the parties, and we therefore affirm the order of the Appellate Division.

On June 10, 1976, Municipal, at the request of the town, submitted a written proposal in the form of a contract to the Town of Ramapo offering to codify its ordinances and local laws for a sum specified in the proposal. On July 21 Municipal agreed to certain changes suggested by the town attorney, but no formal action was taken at that time on behalf of the town on the proposal. Finally, on February 9, 1977 the town board formally acted on it, and agreed to engage petitioner’s services.

By resolution No. 77-54 the town (1) authorized the town attorney to accept the proposal; (2) authorized the supervisor to sign the agreement, and (3) provided payment for the work. The resolution adopted by the town board on February 9, 1977, in pertinent part, provided that:

RESOLVED by the Town Board of the Town of Ramapo that authorization be hereby granted for the Town Attorney to accept the proposal submitted by Municipal Consultants & Publishers, Inc., of 64 Seneca Street, Geneva, New York, to codify Ordinances and Local Laws of the Town of Ramapo, and

BE IT FURTHER RESOLVED that the Supervisor be hereby authorized to execute the Agreement between the Town of Ramapo and Municipal Consultants & Publishers, Inc., and

BE IT FURTHER RESOLVED that the sum of \$ 10,000.00 for the first 450 pages or less and \$ 20.00 per page for each additional page in excess of 450 pages, be hereby paid to Municipal Consultants & Publishers, Inc. for services rendered.

On February 15, 1977, the town attorney notified Municipal that the agreement had been approved, forwarded copies of the agreement for Municipal to execute, and stated he looked forward to a long and pleasant relationship.

Ramapo's supervisor, however, never signed the contract. It appears that one of Municipal's competitors, long after the passage of the resolution authorizing the agreement, offered to do the work for a lesser sum. The parties met in an attempt to work out their differences but to no avail. This [lawsuit] ensued requesting that the court declare the contract valid and enforceable, and also to direct the supervisor and town attorney to deliver an executed copy of the agreement.

The primary issue presented is whether the contract is enforceable against the town without the signature of the supervisor.

Generally, where the parties contemplate that a signed writing is required, there is no contract until one is delivered. *Scheck v. Francis*, 260 N.E.2d 493 (N.Y. 1970). This rule yields, however, when the parties have agreed on all contractual terms and have only to commit them to writing. When this occurs, the contract is effective at the time the oral agreement is made, although the contract is never reduced to writing and signed. Where all the substantial terms of a contract have been agreed on, and there is nothing left for future settlement, the fact, alone, that it was the understanding that the contract should be formally drawn up and put in writing, did not leave the transaction incomplete and without binding force, in the absence of a positive agreement that it should not be binding until so reduced to writing and formally executed. *Disken v Herter*, 77 N.Y.S. 300 (Sup. Ct. App. Div. 1902), *affd*, 67 N.E. 1081 (N.Y. 1903); 1 WILLISTON, CONTRACTS, § 28.

Here, of course, there was no understanding that the agreement would not be binding, short of formal execution by the supervisor; and the facts of the case before us fall within the legal framework of the last above-cited cases. All the terms of the contract had been negotiated and agreed upon. They were, in fact, expressed in Municipal's written standard contract which had been modified in several slight respects through negotiations. There was no understanding or agreement that the contract would not be binding until both parties had signed it, and therefore it is enforceable although it was never memorialized with a mutually signed writing.

Accordingly, the order of the Appellate Division should be affirmed, with costs.

Review Question 9. Did the *Municipal Consultants* court really just say that a contract was accepted and binding *before* one of the parties signed it on the dotted line? If so, then what is the point of the signature? At what moment exactly did the contract in this case come into existence? Doesn't that seem like the sort of thing clients would want to know and on which lawyers should be able to offer advice?

Review Question 10. In *Hendricks v. Behee*, the court held that there was no contract even though the offeree had signed. In *Municipal Consultants*, the court held that there was a contract even though the offeree had not signed. Can you explain this apparent discrepancy in outcome?

Problems

Problem 6.1

Thelma says to Louise, “I’m getting a new television, and I’ll sell you my old one for \$300. Do you want it?” Examine each of the following responses and decide whether a contract is formed.

- a. Louise says, “That sounds pretty good.”
- b. Louise says, “Yes, I’ll take it.”
- c. Louise says, “Yes, I’ll take it. Is it possible for you to deliver it to my apartment?”
- d. Louise says, “Yes, I’ll take it, if you can deliver it to my apartment for me.”
- e. Louise says, “Yes, I’ll take it, if I can get my Mom to loan me the money.”
- f. Louise says, “Can you do any better on the price?” Thelma says “No.” Louise says, “I’ll take it.”

Problem 6.2

On April 10, Olivia Owner offers Peter Painter \$5,000 to paint the exterior of Owner’s lakefront cabin. The job will, however, require scraping off some of the older paint around the porch that has been peeling. Painter says he is not sure he can do it for that price. Owner, who is about to leave on a fourteen-day cruise in the Mediterranean, says, “Well, think about it. You can decide while I’m off on the holiday. If you agree, just go ahead and do it.” Owner then departs.

Two days later, on April 12, Painter goes to the cabin and spends six hours scraping paint. This takes much more time than Painter estimated, and he realizes that this job would be much more work than he expected and that he would need to get more than \$5,000 for the work. He quits and leaves the premises. The next day, April 13, Painter is offered a job that pays a good deal more and will take a couple of weeks to complete. He immediately emails Owner that he’s decided not to do the lakefront cabin job. Owner is unable to check emails for a few days, and ultimately sees Painter’s message on April 15. When Owner returns, she discovers that she cannot hire anyone else to paint the cabin for less than \$8,500. She demands that

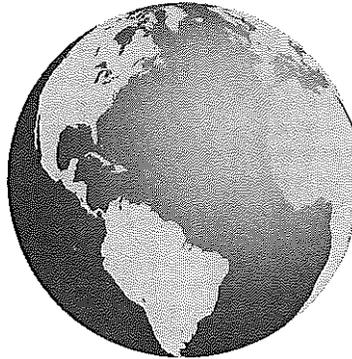
Painter finish the work. He refuses. She hires another company and sues for the \$3,500. Painter moves for summary judgment on the ground that no contract was ever formed. What will the two sides argue in this case? You might find sections 45 and 62 of the Restatement (Second) of Contracts helpful in answering this question.

Problem 6.3

Owner has a piece of property called Blackacre. Buyer is interested in purchasing it. The following exchange takes place:

- May 1** Buyer sends a letter to Owner, offering to buy Blackacre for \$50,000.
- May 2** Buyer sends a second letter to Owner withdrawing the offer.
- May 3** Owner receives Buyer's 5/1 letter which includes the offer.
- May 4** (10 a.m.) Owner mails an acceptance of the 5/1 offer.
- May 4** (4 p.m.) Owner receives Buyer's 5/2 letter withdrawing the offer.
- May 5** Owner mails a revocation of its 5/4 letter of acceptance.
- May 6** Buyer receives Owner's 5/4 letter of acceptance.
- May 7** Buyer receives Owner's 5/4 letter revoking the acceptance.

It is now May 10, and Buyer decides she wants to purchase the property. Is there a contract? Why or why not?



AMERICAN CONTRACT LAW FOR A GLOBAL AGE

Chapter II: Consideration

Unit 7: The Basic Requirement of Consideration

Unit 8: Special Issues With Consideration

Unit 9: Promissory Estoppel as a Substitute

An Introduction to CONSIDERATION

The definition of “contract,” according to section 1 of the Restatement (Second) of Contracts, is “a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty.” To a certain extent this is a circular definition—the law enforces a promise if it a “contract,” and it is a “contract” if the law enforces it. But the important thing to note is that enforceable contracts are a subset of all promises, and thus it becomes critical to be able to distinguish those that are legally enforceable from those that are not.

Drawing Lines for Enforcement. At early common law—and for millennia before that—enforceable promises were usually distinguished by their use of specific rituals or forms. There are countless ritual forms used in various places and times, ranging from the relatively simple (holding hands over a sacred stone) to the extremely elaborate (preparing a scroll, killing a sacrificial animal, smearing its blood on the parties and the document, and then burying the scroll). Obviously, as commerce grew, contracting became common, and people from one culture began to trade with others, these sorts of elaborate rituals became cumbersome. Thus, commercial cultures tended to develop relatively simple forms that were used to distinguish enforceable from unenforceable promises.

The English Approach to Formality. In England, the sign of an enforceable agreement ultimately took the form of a wax seal impressed with a signet. Sealed contracts were enforceable simply because they were correctly sealed. Even seals are cumbersome—not everybody has a signet ring and a candle handy—and so over time the use of special formalities came to be displaced by a different approach. The common law courts, who by definition were making things up as they went along out of existing custom and practice, began to focus less on the *form* that the agreement took, but rather on the *kind* of agreement it was. By the 19th century, courts had clearly swung around to the position that a promise was enforceable if it was supported by *consideration*. Exactly how and why this change came out—and whether it was a good idea—is the subject of some discussion among contract law scholars, but by the turn of the 20th century it was clear that in American law a promise generally had to be supported by consideration to be enforceable as a contract. Whether that is still the case is something you will discover from the materials that follow.

A note of caution. If you think “a promise that involves consideration” means “a promise that you thought seriously about,” you are wrong. “Consideration” is one of those legal terms of art that means something very different from what it means in ordinary usage. Stay tuned.

Unit 7: The Basic Consideration Requirement

CONSIDERATION

Part One

FOCUS OF THIS UNIT

One early—and for our purposes, analytically useful—theory of the origin of consideration came from the idea that an exchange enforceable at law should ultimately consist of *quid pro quo* (literally, “this for that”). If *A* gives *B* \$5,000 in exchange for *B*’s old car, each gets a benefit and each suffers a detriment. *A*, in this example, “benefits” from getting the car, but suffers a “detriment” in having to give up \$5,000. Over the years the requirement of consideration has evolved far beyond a simple *quid pro quo*, as we will see in this section. Without consideration, classical contract considered such promises to be *nudum pactum ex quo non oritur actio*.¹

Unenforceable Gift Promises. Promises to make gifts are outside the *quid pro quo* paradigm and, in most cases, not legally enforceable based on lack of consideration. If Snyder plans to give you a bottle of Scotch for Christmas and you plan to give Snyder a necktie, then the two of you are exchanging gifts. Snyder would get to keep the necktie even if he forgot to get you anything, just as you would be free to keep the Scotch even if you were ungrateful enough not to get Snyder a gift. No contract arises between the parties to a gift. Gifts are, in legal parlance, “gratuitous transfers.” If a person promises to give you a gift, the promise is not usually enforceable. Once a gift has been given to you (or “delivered”) the gift is complete. The giver has no legal right to take the gift back.

The existence of a gift (rather than a *quid pro quo* exchange) has important implications in contract law. Suppose, again, that you *promised* to give Snyder a tie, you bought the tie, and you wrapped up the tie. At this point, you are not legally obliged to give Snyder the tie. Your promise was gratuitous and is not enforceable,

¹ [Translated, the Latin phrase means, “a naked promise from which no action can arise.” The quotation is from the House of Lords opinion in *Rann v. Hughes*, 101 Eng. Rep. 1014 (1778). The principle dates back to Roman law, in which a *pactum* was an agreement that was enforceable if it fell into a specified class. If not, it was *nudum* or “bare.” In such situations, if the promisor had performed he could not get the performance back, but he could not be compelled to perform. – Eds.]

and you are free to change your mind up until the moment of delivery. Snyder is equally free to keep the bottle of Scotch.

Bargained-for Exchange. But what if we change the facts slightly? Suppose this time that you and Snyder agree that he will trade you a bottle of Scotch for a necktie. At that point, rather than a gift, the two of you have a “bargained-for exchange.”² The Scotch and the necktie, both being things of value exchanged for each other, are each “consideration” for each other. You and Snyder now have a contract, and legal liability occurs *at the time the promise is made*. No actual delivery is required.

Distinguishing gifts from contracts is usually not difficult. An employee typically does not offer her services free to her employer; the grocery store is not usually giving away its food; and your internet service provider usually is not providing you broadband access out of the goodness of its heart. In the ordinary commercial world most transactions occur through trade, not by gift. In some situations, however, telling whether one party is giving someone a gift or is bargaining for something in return can be challenging. The key question is whether the thing or the promise is offered *to get something in return*. Since one always expects to get gratitude for a gift, that “something” must be more than just a warm feeling. It must be something that has “value in the eyes of the law.” Exactly what that means is a matter of some complexity.

A Three-Part Analysis. As you read the cases and materials below, keep in mind three distinct questions. First, is there a *promise*? The definition of a promise is a pledge to do (or not do) some particular thing. Thus, a statement like, “I will take out the trash this afternoon if I decide to,” is not a promise—merely the *illusion* of a promise—because there is no actual statement that the promisor is going to do anything. Second, is it a promise to do something that *the promisor is not already obligated to do*? You can’t “bargain” for something that the other party is already obligated to do, such as not committing murder, refraining from snorting cocaine, or obeying traffic laws. Third, is the promise part of a *bargain* that involves an *exchange*? A simple promise to take out the trash is gratuitous. But if it is given *in exchange for* the promisee’s promise to unload the dishwasher, it is a bargain.

You might find it useful to review sections 71-77 of the Restatement (Second) of Contracts as you work your way through this unit.

² [Be careful with this word “bargain.” In common usage, it has at least three meanings: (1) an agreement between parties under which each will do something for the other; (2) the process of negotiating a deal (“bargaining” over the terms); and (3) a particularly good deal (“it’s a real bargain”). The first meaning is the one we use in contract law. We tend to use the words “negotiate” or (in older materials) “dicker” to mean the second sense. And whether the deal is good or bad is irrelevant to the question whether it is a “bargain” in our sense. – Eds.]

Cases and Materials

RIDGE RUNNER FORESTRY v. VENEMAN

United States Court of Appeals for the Federal Circuit
287 F.3d 1058 (Fed. Cir. 2002)

MAYER, C.J.

Ridge Runner Forestry appeals from the decision of the Department of Agriculture Board of Contract Appeals dismissing its cause of action for lack of jurisdiction. Because no contract had been formed, we affirm the board's decision.

Ridge Runner Forestry is a fire protection company located in the Pacific Northwest. In response to a request for quotations ("RFQ") issued by the Forestry Service, Ridge Runner submitted a proposal and ultimately signed a document entitled Pacific Northwest Interagency Engine Tender Agreement ("Tender Agreement"). The Tender Agreement incorporated the RFQ in its entirety, including the following two provisions in bold faced lettering: (1) "Award of an Interagency Equipment Rental Agreement based on response to this Request for Quotations (RFQ) does not preclude the Government from using any agency or cooperator or local EERA resources"; and (2) "Award of an Interagency Equipment Rental Agreement does not guarantee there will be a need for the equipment offered nor does it guarantee orders will be placed against the awarded agreements." Additionally, because the government could not foresee its actual equipment needs, the RFQ contained language that allowed the contractor to decline the government's request for equipment for any reason: "Because the equipment needs of the government and availability of contractor's equipment during an emergency cannot be determined in advance, it is mutually agreed that, upon request of the government, the contractor shall furnish the equipment offered herein *to the extent the contractor is willing and able at the time of order*" (emphasis added). The RFQ also included a clause informing bidders that they would not be reimbursed for any costs incurred in submitting a quotation. Ridge Runner signed Tender Agreements in 1996, 1997, 1998, and 1999. In 1999, it presented a claim for \$180,000 to the contracting officer alleging that the Forestry Service had violated an "implied duty of good faith and fair dealing" because Ridge Runner had been "systematically excluded for the past several years from providing services to the Government." In response, the contracting officer.³ told

³ [The process for contracting with the United States government is somewhat different than contracting with a private entity. Contracts are signed by an officially designated agency official called a "contracting officer," who has the power to sign agreements for the United States. The contracting officer is also ultimately responsible for administering the contract on behalf of the government. If a

Ridge Runner that she lacked the proper authority to decide the claim [because the Agreement was not a contract]. Ridge Runner timely appealed the decision to the Department of Agriculture Board of Contract Appeals. The board granted the government's motion to dismiss concluding that because no contract had been entered into, it lacked jurisdiction under the Contract Disputes Act.

We have jurisdiction over an appeal from a decision of an agency board of contract appeals. The board's jurisdiction under the CDA requires, at a minimum, a contract between an agency and another party. Therefore, the threshold matter is whether the Tender Agreements constituted contracts between the parties, which is a question of law that we review *de novo*.

“To be valid and enforceable, a contract must have both consideration to ensure mutuality of obligation and sufficient definiteness so as to ‘provide a basis for determining the existence of a breach and for giving an appropriate remedy.’” *Ace-Federal Reporters, Inc. v. Barram*, 226 F.3d 1329, 1332 (Fed. Cir. 2000). “To constitute consideration, a performance or a return promise must be bargained for.” Restatement (Second) of Contracts § 71(1) (1979). And the “promise or apparent promise is not consideration if by its terms the promisor or purported promisor reserves a choice of alternative performances.” *Id.* § 77.

Ridge Runner argues that the Tender Agreement was a binding contract that placed specific obligations upon the government; namely, the government was obligated to call upon Ridge Runner, and the other winning vendors, for its fire fighting needs, and in return, the vendors were to remain ready with acceptable equipment and trained staff to answer the government's call. This, Ridge Runner argues, places the alleged contract squarely within our [earlier] holding in *Ace-Federal*.

Ace-Federal involved a requirements contract whereby the government was obligated to use, with limited exceptions, enumerated suppliers. We held that “each time an agency [acquired goods from] a non-contract source, the government breached the contract.”

The contract in *Ace-Federal* is quite distinct from the Tender Agreements at issue in this case. That contract obligated the government to fulfill all of its requirements for transcription services from enumerated vendors or obtain a waiver. The Tender Agreements here are nothing but illusory promises. By the phrase illusory promise is meant words in promissory form that promise nothing; they do not purport to put any limitation on the freedom of the alleged promisor, but leave his

contractual dispute arises, the private party generally cannot sue. The contractor's claim must first be presented to the contracting officer for her determination. If she denies the contractor's claim, the contractor can appeal to another part of the agency, called usually called the Board of Contract Appeals. If the Board denies the claim, the contractor can appeal to a federal court. That is what happened in this case. – Eds.]

future action subject to his own future will, just as it would have been had he said no words at all. *Torncello v. United States*, 681 F.2d 756, 769 (Ct. Cl. 1982) (quoting 1 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 145 (1963)). The government had the option of attempting to obtain firefighting services from Ridge Runner or any other source, regardless of whether that source had signed a tender agreement. The Agreements contained no clause limiting the government's options for firefighting services; the government merely "promised" to consider using Ridge Runner for firefighting services. Also, the Tender Agreement placed no obligation upon Ridge Runner. If the government came calling, Ridge Runner "promised" to provide the requested equipment only if it was "willing and able." It is axiomatic that a valid contract cannot be based upon the illusory promise of one party, much less illusory promises of both parties. See Restatement (Second) of Contracts § 71(1).

Accordingly, the decision of the Department of Agriculture Board of Contract Appeals is affirmed.

Review Question 1. "The Tender Agreements here are nothing but illusory promises," says the Federal Circuit Court of Appeals, and therefore lacked consideration to support the existence of an enforceable contract. Think about the distinction the court draws with the *Ace Federal* case it discusses. What makes a promise "illusory" such that it lacks consideration?

JANKOWSKI v. MONCLOVA-MAUMEE-TOLEDO
JOINT ECONOMIC DEVELOPMENT ZONE
Court of Appeals of Ohio
185 Ohio App. 3d 568, 924 N.E.2d 932 (2010)

[Three local government entities created a special Joint Economic Development Zone in Monclova Township. After the JEDZ was created, it entered into a contract with the township to receive certain government services.]

The "governmental services" contract between the Joint Economic Development Zone and Monclova township provides that the township "shall furnish or cause to be furnished to the properties included in the JEDZ territory, all usual and customary governmental services furnished by Monclova to other comparable properties in Monclova, including: fire protection, medical rescue, and road maintenance services." In return Monclova Township is to receive one-third of the net tax revenues from the zone.

We conclude that the territory encompassed in the Monclova-Maumee-Toledo JEDZ remains a part of Monclova Township. As such, the occupiers of property within the zone are entitled to the same governmental services provided elsewhere in Monclova Township. Moreover, the Monclova Township Trustees have the same duty to provide usual and customary governmental services in the JEDZ as they do elsewhere in the township.

As a result, the Trustees of Monclova Township have a pre-existing legal duty to perform governmental services within the JEDZ, which are the same services that they have contracted to provide to the JEDZ in return for compensation. “Performance of a legal duty owed to a promisor which is neither doubtful nor the subject of honest dispute is not consideration.” Restatement (Second) of Contracts § 73 (1979). Consideration is an essential element of any contract, without which there is no contract.

As a matter of law, Monclova Township has a duty to provide usual and customary governmental services in the JEDZ. Since the contract between the township and the JEDZ is premised on the consideration of the township performing services that it is already legally obligated to provide, the contract fails for want of consideration.

Review Question 2. The case described what contract law calls the “preexisting duty rule,” which you can find in section 73 of the *Second Restatement*. Promising to do something that you already have a duty to do—or, on the flip side, promising not to do something you have no right to do—is not consideration. Does that rule make sense to you or is it preventing useful contracts from being formed? If someone wants to promise you more to make sure you obey the speed limit or don’t do dangerous drugs, why shouldn’t the law enforce a promise to do so?

SCHNELL v. NELL
Supreme Court of Indiana
17 Ind. 29 (1861)

PERKINS, J.

Action by J. B. Nell against Zacharias Schnell, upon the following instrument:

This agreement, entered into this *13th* day of *February, 1856*, between *Zach. Schnell*, of *Indianapolis, Marion* county, State of *Indiana*, as party of the first part, and *J. B. Nell*, of the same place, *Wendelin Lorenz*, of *Stilesville, Hendricks* county, State of *Indiana*, and *Donata Lorenz*, of *Frickinger, Grand Duchy of Baden, Germany*, as

parties of the second part, witnesseth: The said *Zacharias Schnell* agrees as follows: whereas his wife, *Theresa Schnell*, now deceased, has made a last will and testament, in which, among other provisions, it was ordained that every one of the above named second parties, should receive the sum of \$200; and whereas the said provisions of the will must remain a nullity, for the reason that no property, real or personal, was in the possession of the said *Theresa Schnell*, deceased, in her own name, at the time of her death, and all property held by *Zacharias* and *Theresa Schnell* jointly, therefore reverts to her husband; and whereas the said *Theresa Schnell* has also been a dutiful and loving wife to the said *Zach. Schnell*, and has materially aided him in the acquisition of all property, real and personal, now possessed by him; for, and in consideration of all this, and the love and respect he bears to his wife; and, furthermore, in consideration of one cent, received by him of the second parties, he, the said *Zach. Schnell*, agrees to pay the above named sums of money to the parties of the second part, to wit: \$200 to the said *J. B. Nell*; \$200 to the said *Wendelin Lorenz*; and \$200 to the said *Donata Lorenz*, in the following installments, viz., \$200 in one year from the date of these presents; \$200 in two years, and \$200 in three years; to be divided between the parties in equal portions of \$66 ²/₃ each year, or as they may agree, till each one has received his full sum of \$200. And the said parties of the second part, for, and in consideration of this, agree to pay the above named sum of money [one cent], and to deliver up to said *Schnell*, and abstain from collecting any real or supposed claims upon him or his estate, arising from the said last will and testament of the said *Theresa Schnell*, deceased.

In witness whereof, the said parties have, on this 13th day of *February*, 1856, set hereunto their hands and seals.

Zacharias Schnell [seal.]

J. B. Nell [seal.]

Wen. Lorenz [seal]

The complaint contained no averment of a consideration for the instruments outside of those expressed in it; and did not aver that the one cent agreed to be paid, had been paid or tendered.

A demurrer to the complaint was overruled.

The defendant answered, that the instrument sued on was given for no consideration whatever.

He further answered, that it was given for no consideration, because his said wife, Theresa, at the time she made the will mentioned, and at the time of her death, owned, neither separately, nor jointly with her husband, or any one else (except so far as the law gave her an interest in her husband's property), any property, real or personal, &c.

The will is copied into the record, but need not be into this opinion.

The Court sustained a demurrer to these answers, evidently on the ground that they were regarded as contradicting the instrument sued on, which particularly set out the considerations upon which it was executed. But the instrument is latently ambiguous on this point.

The case turned below, and must turn here, upon the question whether the instrument sued on does express a consideration sufficient to give it legal obligation, as against Zacharias Schnell. It specifies three distinct considerations for his promise to pay \$600:

1. A promise, on the part of the plaintiffs, to pay him one cent.
2. The love and affection he bore his deceased wife, and the fact that she had done her part, as his wife, in the acquisition of property.
3. The fact that she had expressed her desire, in the form of an inoperative will, that the persons named therein should have the sums of money specified.

The consideration of one cent will not support the promise of Schnell. It is true, that as a general proposition, inadequacy of consideration will not vitiate an agreement. *Baker v. Roberts*, 14 Ind. 457 (1860). But this doctrine does not apply to a mere exchange of sums of money, of coin, whose value is exactly fixed, but to the exchange of something of, in itself, indeterminate value, for money, or, perhaps, for some other thing of indeterminate value. In this case, had the one cent mentioned, been some particular one cent, a family piece, or ancient, remarkable coin, possessing an indeterminate value, extrinsic from its simple money value, a different view might be taken. As it is, the mere promise to pay six hundred dollars for one cent, even had the portion of that cent due from the plaintiff been tendered, is an unconscionable contract, void, at first blush, upon its face, if it be regarded as an earnest one. *Hardesty v. Smith*, 3 Ind. 39 (1851). The consideration of one cent is, plainly, in this case, merely nominal, and intended to be so. As the will and testament of Schnell's wife imposed no legal obligation upon him to discharge her bequests out of his property, and as she had none of her own, his promise to discharge them was not legally binding upon him, on that ground. A moral consideration, only, will not support a promise.

And for the same reason, a valid consideration for his promise can not be found in the fact of a compromise of a disputed claim; for where such claim is legally groundless, a promise upon a compromise of it, or of a suit upon it, is not legally

binding. *Spahr v. Hollingshead*, 8 Blackf. 415 (Ind. 1847). There was no mistake of law or fact in this case, as the agreement admits the will inoperative and void. The promise was simply one to make a gift. The past services of his wife, and the love and affection he had borne her, are objectionable as legal considerations for Schnell's promise, on two grounds: (1) They are past considerations. (2) The fact that Schnell loved his wife, and that she had been industrious, constituted no consideration for his promise to pay J. B. Nell, and the Lorenzes, a sum of money. Whether, if his wife, in her lifetime, had made a bargain with Schnell, that, in consideration of his promising to pay, after her death, to the persons named, a sum of money, she would be industrious, and worthy of his affection, such a promise would have been valid and consistent with public policy, we need not decide.

Nor is the fact that Schnell now venerates the memory of his deceased wife, a legal consideration for a promise to pay any third person money.

The instrument sued on, interpreted in the light of the facts alleged in the second paragraph of the answer, will not support an action. The demurrer to the answer should have been overruled. *See Stevenson v. Druley*, 4 Ind. 519 (1853).

Review Question 3. Schnell appears to have—acting of his own free will—intended to legally bind himself to pay money to Nell and the Lorenzes. Why should the law *not* compel him to perform? Should a general policy preference for freedom of contract apply in this situation? If we are going to enforce some promises as contracts, then why not enforce this one?

Review Question 4. The agreement signed by Schnell recites several different things that *might* amount to consideration. Make a list of the various items and try to see why they do not amount to “consideration.”

HAMER v. SIDWAY
Court of Appeals of New York
79 Sickels 538, 124 N.Y. 538, 27 N.E. 256 (1891)

APPEAL from order of the General Term of the Supreme Court in the fourth judicial department, made July 1, 1890, which reversed a judgment in favor of plaintiff entered upon a decision of the court on trial at Special Term and granted a new trial.

This action was brought upon an alleged contract.

The plaintiff presented a claim to the executor of William E. Story, Sr., for \$5,000 and interest from the 6th day of February, 1875. She acquired it through several mesne assignments from William E. Story, 2d. The claim being rejected by the executor, this action was brought.

It appears that William E. Story, Sr., was the uncle of William E. Story, 2d; that at the celebration of the golden wedding of Samuel Story and wife, father and mother of William E. Story, Sr., on the 20th day of March, 1869, in the presence of the family and invited guests he promised his nephew that if he would refrain from drinking, using tobacco, swearing and playing cards or billiards for money until he became twenty-one years of age he would pay him a sum of \$5,000. The nephew assented thereto and fully performed the conditions inducing the promise. When the nephew arrived at the age of twenty-one years and on the 31st day of January, 1875, he wrote to his uncle informing him that he had performed his part of the agreement and had thereby become entitled to the sum of \$5,000.

The uncle received the letter and a few days later and on the sixth of February, he wrote and mailed to his nephew the following letter:

BUFFALO, Feb. 6, 1875.

W. E. STORY, Jr.:

DEAR NEPHEW—Your letter of the 31st ult. came to hand all right, saying that you had lived up to the promise made to me several years ago. I have no doubt but you have, for which you shall have five thousand dollars as I promised you. I had the money in the bank the day you was 21 years old that I intend for you, and you shall have the money certain. Now, Willie I do not intend to interfere with this money in any way till I think you are capable of taking care of it and the sooner that time comes the better it will please me. I would hate very much to have you start out in some adventure that you thought all right and lose this money in one year. The first five thousand dollars that I got together cost me a heap of hard work. You would hardly believe me when I tell you that to obtain this I shoved a jackplane many a day, butchered three or four years, then came to this city, and after three months' perseverance I obtained a situation in a grocery store. I opened this store early, closed late, slept in the fourth story of the building in a room 30 by 40 feet and not a human being in the building but myself. All this I done to live as cheap as I could to save something. I don't want you to take up with this kind of fare. I was here in the cholera season '49 and '52 and the deaths averaged 80 to 125 daily and plenty of small-pox. I wanted to go home, but Mr. Fisk, the gentleman I was working for, told me if I left then, after it got healthy he probably would not want me. I

stayed. All the money I have saved I know just how I got it. It did not come to me in any mysterious way, and the reason I speak of this is that money got in this way stops longer with a fellow that gets it with hard knocks than it does when he finds it. Willie, you are 21 and you have many a thing to learn yet. This money you have earned much easier than I did besides acquiring good habits at the same time and you are quite welcome to the money; hope you will make good use of it. I was ten long years getting this together after I was your age.

Truly Yours,
W. E. STORY.

P. S. You can consider this money on interest.

The nephew received the letter and thereafter consented that the money should remain with his uncle in accordance with the terms and conditions of the letters. The uncle died on the 29th day of January, 1887, without having paid over to his nephew any portion of the said \$5,000 and interest.

PARKER, J.: The question which provoked the most discussion by counsel on this appeal, and which lies at the foundation of plaintiff's asserted right of recovery, is whether by virtue of a contract defendant's testator William E. Story became indebted to his nephew William E. Story, 2d, on his twenty-first birthday in the sum of five thousand dollars. The trial court found as a fact that "on the 20th day of March, 1869, William E. Story agreed to and with William E. Story, 2d, that if he would refrain from drinking liquor, using tobacco, swearing, and playing cards or billiards for money until he should become 21 years of age then he, the said William E. Story, would at that time pay him, the said William E. Story, 2d, the sum of \$5,000 for such refraining, to which the said William E. Story, 2d, agreed," and that he "in all things fully performed his part of said agreement."

The defendant contends that the contract was without consideration to support it, and, therefore, invalid. He asserts that the promisee by refraining from the use of liquor and tobacco was not harmed but benefitted; that which he did was best for him to do independently of his uncle's promise, and insists that it follows that unless the promisor was benefitted, the contract was without consideration. A contention, which if well founded, would seem to leave open for controversy in many cases whether that which the promisee did or omitted to do was, in fact, of such benefit to him as to leave no consideration to support the enforcement of the promisor's agreement. Such a rule could not be tolerated, and is without foundation in the law. The Exchequer Chamber, in 1875, defined consideration as follows: "A valuable consideration in the sense of the law may consist either in some right, interest, profit or benefit accruing to the one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other." Courts "will not ask whether the thing which forms the

consideration does in fact benefit the promisee or a third party, or is of any substantial value to anyone. It is enough that something is promised, done, forborne or suffered by the party to whom the promise is made as consideration for the promise made to him.” WILLIAM R. ANSON, *PRINCIPLES OF THE ENGLISH LAW OF CONTRACT* 63 (1884).

“In general a waiver of any legal right at the request of another party is a sufficient consideration for a promise.” THEOPHILUS PARSONS, *THE LAW OF CONTRACTS* 444 (7th ed. 1883).

“Any damage, or suspension, or forbearance of a right will be sufficient to sustain a promise.” 2 JAMES KENT, *COMMENTARIES ON AMERICAN LAW* 465 (12th ed. 1873).

Pollock, in his work on contracts, page 166, after citing the definition given by the Exchequer Chamber already quoted, “The second branch of this judicial description is really the most important one. Consideration means not so much that one party is profiting as that the other abandons some legal right in the present or limits his legal freedom of action in the future as an inducement for the promise of the first.” FREDERICK POLLOCK, *THE PRINCIPLES OF CONTRACT* 166 (1876).

Now, applying this rule to the facts before us, the promisee used tobacco, occasionally drank liquor, and he had a legal right to do so. That right he abandoned for a period of years upon the strength of the promise of the testator that for such forbearance he would give him \$5,000. We need not speculate on the effort which may have been required to give up the use of those stimulants. It is sufficient that he restricted his lawful freedom of action within certain prescribed limits upon the faith of his uncle’s agreement, and now having fully performed the conditions imposed, it is of no moment whether such performance actually proved a benefit to the promisor, and the court will not inquire into it, but were it a proper subject of inquiry, we see nothing in this record that would permit a determination that the uncle was not benefitted in a legal sense. Few cases have been found which may be said to be precisely in point, but such as have been support the position we have taken.

In *Shadwell v. Shadwell*, 143 Eng. Rep. 62 (C.P. 1860), an uncle wrote to his nephew as follows:

MY DEAR LANCEY—I am so glad to hear of your intended marriage with Ellen Nicholl, and as I promised to assist you at starting, I am happy to tell you that I will pay to you 150 pounds yearly during my life and until your annual income derived from your profession of a chancery barrister shall amount to 600 guineas, of which your own admission will be the only evidence that I shall require.

Your affectionate uncle,
CHARLES SHADWELL.

It was held that the promise was binding and made upon good consideration.

In *Lakota v. Newton*, an unreported case in the Superior Court of Worcester, Mass., the complaint averred defendant's promise that "if you (meaning plaintiff) will leave off drinking for a year I will give you \$100," plaintiff's assent thereto, performance of the condition by him, and demanded judgment therefor. Defendant demurred on the ground, among others, that the plaintiff's declaration did not allege a valid and sufficient consideration for the agreement of the defendant. The demurrer was overruled.

In *Talbott v. Stemmons' Executor*, 12 S.W. 297 (Ky. Ct. App. 1889), the step-grandmother of the plaintiff made with him the following agreement: "I do promise and bind myself to give my grandson, Albert R. Talbott, \$500 at my death, if he will never take another chew of tobacco or smoke another cigar during my life from this date up to my death, and if he breaks this pledge he is to refund double the amount to his mother." The executor of Mrs. Stemmons demurred to the complaint on the ground that the agreement was not based on a sufficient consideration. The demurrer was sustained and an appeal taken therefrom to the Court of Appeals, where the decision of the court below was reversed. In the opinion of the court it is said that "the right to use and enjoy the use of tobacco was a right that belonged to the plaintiff and not forbidden by law. The abandonment of its use may have saved him money or contributed to his health, nevertheless, the surrender of that right caused the promise, and having the right to contract with reference to the subject-matter, the abandonment of the use was a sufficient consideration to uphold the promise."

Abstinence from the use of intoxicating liquors was held to furnish a good consideration for a promissory note in *Lindell v. Rokes*, 60 Mo. 249 (1870).

The order appealed from should be reversed and the judgment of the Special Term affirmed, with costs payable out of the estate.

Review Question 5. The promisors in *Schnell v. Nell* and in *Hamer v. Sidway* both appear to have made sincere promises that were motivated by affection and family ties. Which facts in *Hamer* were legally relevant in enabling the promisee⁴ to win while the promisees in *Schnell* lost?

WEAVERTOWN TRANSPORT LEASING, INC. v. MORAN

Superior Court of Pennsylvania
834 A.2d 1169 (Pa. Super. Ct. 2003)

JOHNSON, J.

In July of 2000, Appellant-Defendant Daniel Moran, a certified public accountant, accepted employment as controller for Appellee-Plaintiff Weavertown Transport Leasing, Inc. That summer, the Pittsburgh Steelers National Football League franchise prepared to relocate from Three Rivers Stadium to its new home, Heinz Field. Moran, a long-time season ticket-holder to Steelers' home games at Three Rivers Stadium, was offered four season tickets to Heinz Field comparable to his seats at Three Rivers Stadium as well as the opportunity to secure additional seats. Moran paid \$11,000 for thirty-year licenses to the four seats that corresponded to his former seats. He also agreed to purchase seven-year licenses to four Club-Level seats, which cost \$3,840. The purchase agreements precluded Moran from selling or transferring his licenses to another party for at least one year after purchase, but allowed for transfer thereafter.

While these transactions took place, Moran began employment as Weavertown's controller. Soon after his arrival, he learned through Weavertown's President, Dawn Fuchs-Heiser, that the Company sought full ownership of season tickets to Heinz Field to entertain its clients. These tickets would augment the Company's season tickets to see the Pittsburgh Penguins at Mellon Arena and the Pittsburgh Pirates at PNC Park. In prior years, the Company had purchased tickets to many Steelers home games on a per-game basis from another holder of season tickets. For the 2001/2002 season, Fuchs-Heiser agreed to buy them from Moran.

The parties dispute the nature of the agreement Moran and Fuchs-Heiser reached on behalf of Weavertown. The trial court, however, found unequivocally that Moran "offered to sell both the seat license fee to [Weavertown] and the accompanying

⁴ [Actually, plaintiff Louisa Hamer was not the original promisee, but rather was the eventual assignee of the rights of William E. Story II. As such, Hamer "stood in the shoes" of the younger Story and had the ability to assert his rights against Franklin Sidway, who was the executor of the estate of the elder William E. Story. Toward the end of this book, we will cover the concept of *assignment* in more detail. – Eds.]

season tickets for the Steelers to [Weavertown] and to transfer the seat license from his name to that of [Weavertown] when the Steelers would permit [Moran] to do so.” To that end, Weavertown wrote checks totaling \$3,840 to the Stadium Building Fund (SBF) for the license fees corresponding to four Club Level seats, and then wrote a check for \$5,804 to the Steelers for the face value of the 2001/2002 season tickets. These checks were delivered to Moran, who in turn sent them to the appropriate bodies. When he received the tickets he gave them to the Company. When the Steelers earned a playoff berth at the end of the 2001/2002 season, Weavertown purchased seats for those games for \$1,283—again by giving a check to Moran who delivered it to the appropriate Steelers office.

On May 11, 2001, before the Steelers began their first season at Heinz Field, Moran resigned his position with Weavertown. He nonetheless in no way interfered with Weavertown’s usage of the seats in dispute throughout that season and during the playoffs. After the 2001/2002 NFL playoffs, in the spring of 2002, Fuchs-Heiser asked Moran when he would be able to transfer the licenses to Weavertown. Moran denied that he had ever intended to transfer the licenses. He did, however, tender a check to Weavertown equal to six-sevenths of the seat license fee Weavertown had furnished to the SBF—ostensibly to offset, on a pro rata basis, the license fees for the six years remaining on the licenses. Weavertown rejected the offer and initiated this action.

The trial court rejected Moran’s argument that the asserted oral contract failed for want of consideration. It counted Weavertown’s payments to SBF and the Steelers as payments to third parties constituting consideration. Thus, the court found that an oral contract existed between Weavertown and Moran. The court ordered specific performance, directing Moran to transfer the seat licenses and any outstanding Steelers tickets purchased under those licenses. From this order, Moran appeals.

Our standard of review requires us to determine, based on all the evidence, whether the trial court properly applied contract principles. We will not usurp the trial court’s fact-finding function, and will intercede only where the trial court committed an error of law or an abuse of discretion.

A contract is formed when the parties to it (1) reach a mutual understanding, (2) exchange consideration, and (3) delineate the terms of their bargain with sufficient clarity. Consideration consists of a benefit to the promisor or a detriment to the promisee.

It is not enough, however, that the promisee has suffered a legal detriment at the request of the promisor. The detriment incurred must be the ‘quid pro quo’ or the ‘price’ of the promise, and the inducement for which it was made. If the promisor merely intends to make a gift to the promisee upon the performance of a condition, the promise is gratuitous and the satisfaction of the condition is not consideration for a contract.

The distinction between such a conditional gift and a contract is well illustrated in 1 SAMUEL WILLISTON, LAW OF CONTRACTS § 112 (rev. ed. 1936), where it is said: “If a benevolent man says to a tramp,⁵ ‘if you go around the corner to the clothing shop there, you may purchase an overcoat on my credit,’ no reasonable person would understand that the short walk was requested as the consideration for the promise, but that in the event of the tramp going to the shop the promisor would make him a gift.”

Stelmack v. Glen Alden Coal Co., 14 A.2d 127, 128-29 (Pa. 1940).

Moran contends that he received no consideration for the season tickets and seat licenses due to Weavertown’s lack of obligation to the Steelers. Instead, he argues that his arrangement with Weavertown was gratuitous, conditioned on Weavertown’s standing in his place by paying the amounts due the Steelers and SBF for the seats in question. He effectively illustrates his point by observing that, “if the season tickets, for some reason, were no longer valuable, and Weavertown didn’t want them anymore, it is Moran who is obligated to the Pittsburgh Steelers, not Weavertown.”

Weavertown has more in common with Williston’s “tramp” than it does with a promisee obliged to a third-party: Weavertown’s payments directly to SBF and the Steelers set up Moran’s conditional gift granting Weavertown access to four Club Level seats at Heinz Field; SBF and the Steelers were incidental beneficiaries, the benefit to whom cannot be consideration. That Moran arranged it so that Weavertown bore the initial burden of paying the seat licenses does not change the general character of the transaction, as demonstrated by Moran’s unsolicited pre-litigation offer to repay sixth-sevenths of the license fees to Weavertown. Thus, we find no consideration in the arrangement between Moran and Weavertown.

The trial court erred in finding adequate consideration to support an oral contract in the gratuitous arrangement between Moran and Weavertown. Thus, we must reverse the trial court’s order. We recognize, however, that Moran should not receive the benefit of the remaining years on the seat licenses in question without reimbursing Weavertown as the trial court deems appropriate. Thus, we remand for further proceedings consistent with this Opinion.

Review Question 6. Williston’s “tramp” hypothetical is often seen as a simple case of charity: of promising a gift but then reneging on the promise. The interactions between Moran and Weavertown seem much more complex than that. Was Moran

⁵ [By a “tramp,” Professor Williston is referring—in arguably unkind 1930s language—to a homeless man or transient otherwise living on the city streets. – Eds.]

acting charitably? Was he *intending* some sort of gift to his employer? The trial court found a “contract,” which presumes that it found consideration. What arguable consideration could there have been in the agreement to support the trial court’s position? Re-consider section 71 of the Restatement (Second) of Contracts while answering this question.

Problems

Problem 7.1

Antillico’s husband died and left her with several children, little money, and a failing farm. Her brother-in-law, Isaac, heard of her troubles and sent the following letter:

Dear sister Antillico – Much to my mortification, I heard, that brother Henry was dead, and one of his children. I know that your situation is one of grief, and difficulty. You had a bad chance before, but a great deal worse now. I should like to come and see you, but cannot with convenience at present. I do not know whether you have a purchase option on the place you live on, or not. If you had, I would advise you to exercise it and sell the land and quit the country, as I understand it is very unhealthy, and I know society is very bad. If you will come down and see me, I will let you have a place to raise your family, and I have more open land than I can tend; and on the account of your situation, and that of your family, I feel like I want you and the children to do well.

Antillico promptly packed up and move down to Isaac’s place. She stayed there for two years, cultivating the land. Isaac thereupon kicked her off the property. She sued, claiming breach of contract. Isaac argued that there was no consideration for his promise. What result?

Problem 7.2

Fritz is a well-to-do man who owns a cat. The cat, Fluffy, is his constant companion and his pride and joy. Vincent is an itinerant artist who paints pictures of pets. Vincent and Fritz agree that Vincent will paint a picture of Fluffy for \$1,000, provided that Fritz thinks it’s a good likeness. If Fritz does not think the painting a good likeness, he will owe Vincent nothing. Vincent has Fritz sign a brief form recording the transaction. Vincent never gets around to painting Fluffy.

Shortly after his talk with Fritz, Vincent is discovered by a prominent SoHo gallery, which wants to do a solo exhibition of his cat paintings. Suddenly Vincent’s paintings skyrocket in price. After the gallery show, the price of Vincent’s cat paintings has risen to \$250,000. Fritz demands that Vincent paint Fluffy, as agreed.

Vincent refuses. Fritz eventually sues Vincent, claiming that Vincent breached their contract by never painting Fluffy. Assume that if Vincent had painted Fluffy, the painting would be worth about \$250,000. Vincent defends on the ground that there never was a contract because Fritz's promise was illusory.

Who should prevail, Vincent or Fritz? Why?

Problem 7.3

Michael and Hildegard were married and lived in California. A few years after the marriage, Michael began having heart problems and he was admitted to the hospital several times. He became terrified that he would have to be put in a nursing home. He orally promised Hildegard that if she would "care for [him] in his home, for the duration of his illness," he would leave to her a substantial amount of property that she would not ordinarily be entitled to inherit on his death. She cared for him, but he never changed his will, and the property went to his daughter by his first marriage. Upon his death, she sued the estate to get the property. The estate argued that there was no consideration for her promise, because under California law spouses owe each other duties of support and care that cannot be disclaimed. Was there consideration for Michael's promise? Why or why not?

Problem 7.4

(a) Jules owns a men's clothing store in New York. One bitterly cold day, while coming out of his bank, he sees a homeless man walking without a coat. He tells the man, "Look, if you come by my shop this afternoon, I have a coat that I will give you." That afternoon, the man walks the three blocks to Jules's shop. Is Jules bound to give him the coat, or can he change his mind without legal consequences?

(b) Same facts, except that the homeless man is sitting on a heating grate outside of Jules's expensive haberdashery, causing customers to walk past without going inside. Jules tells the man, "If you will go somewhere else for the day, I will give you a coat when you come back at seven when the store closes." The man leaves and goes to another grate three blocks away. Is Jules bound to give him the coat if he returns to the shop at seven?

Unit 8: Special Issues with Consideration

CONSIDERATION Part Two

FOCUS OF THIS UNIT

Some promises are relatively trivial, such as promising to pay back a dollar you borrowed to get a can of soda. Some promises are extraordinarily solemn and important, like a promise to deliver the last letter home for a dying soldier. But enforceability, as we have seen, does not depend on the importance of the promise, but on whether it is supported by consideration—whether there is, in the language of the Restatement (Second) of Contracts, a “bargained-for exchange.”

Modifications? Recall the preexisting duty rule from the last unit. We talked about duties arising under law, but duties can also arise under contracts. Suppose you have a contract to paint your neighbor’s house \$5,000, but you now refuse to do so unless the neighbor promises to pay an extra \$500. As you have a contractual obligation to paint the house \$5,000, there is no consideration for the extra \$500. As you will see from the following materials, however, it may not be quite that simple.

Benefits Already Received? The preexisting duty rule, as we saw, was based on the idea that you can’t bargain for something you’re already entitled to. But what about bargaining for something you’ve already received? You might think that after the cases in the previous unit, the answer would be easy—if you’ve already received something, you are almost by definition not bargaining to get it. An important and oft-cited English case, *Hunt v. Bate*, 73 Eng. Rep. 605 (C.P. 1568), made it clear that a subsequent promise to pay for something already received was not enforceable as a contract. A gift followed by a return gift does not make a “bargained-for exchange.” Yet the doctrine was never quite that clear. In a series of cases, nearly all involving debtors who had promised to repay loans after the loans had been discharged in bankruptcy or barred by the statute of limitations,¹ courts held that if the prior benefit was money received, the subsequent promise was enforceable without new

¹ [You are probably familiar with this concept, but statutes of limitations are rules that require lawsuits to be brought within a particular period of time. Thus, in a particular state a contract claim might have to be brought within four years of the breach; if you wait longer than that to file suit, the claim is barred.—Eds.]

consideration. The reasoning generally was that a debtor was always *morally* obligated to pay back the money, even if the debt was unenforceable, and so that debt acted as consideration.

Moral Obligation? But there obviously are “moral” obligations beyond just repaying debts. In *Style v. Smith*,² another sixteenth century case decided only a few years after *Hunt v. Bate*, the court raised a hypothetical:

If a physician, who is my friend, hearing that my son is sick, goeth to him in my absence and helps and recovers him, and I being informed thereof promise him in consideration . . . to give him £20 an action will lie for the money.

In other words, said the court, the father must pay even though the promise came *after* service was performed. But many cases went the other way, including the influential *Eastwood v. Kenyon*, 11 Ad & E 438; 113 ER 482 (Q.B. 1840). Professor Brian Simpson concluded the English rules relating to moral consideration were “easier to state than to explain.” As you can see from the following cases, these English rules—in all their confusion—were imported largely intact into American law.

As you work through the problems and the readings, try to articulate whether liability is based on the idea of the *promise* or the idea of some kind of *exchange*. Consider sections 86 and 89 of the Restatement (Second) of Contracts in connection with the materials that follow.

² [There is no citation and no formal report of *Style v. Smith* still in existence, although the language was referred to and relied upon in later decisions. The quote here is taken from A. W. BRIAN SIMPSON, A HISTORY OF THE LAW OF CONTRACT: THE RISE OF ASSUMPSIT 456 (1975). – Eds.]

Cases and Materials

ALASKA PACKERS' ASSOCIATION v. DOMENICO

Circuit Court of Appeals, Ninth Circuit

117 F. 99 (1902)

ROSS, Circuit Judge.

The libel³ in this case was based upon a contract alleged to have been entered into between the libellants and the appellant corporation on the 22d day of May, 1900, at Pyramid Harbor, Alaska.

The evidence shows without conflict that on March 26, 1900, at the city and county of San Francisco, the libellants entered into a written contract with the appellant, whereby they agreed to go from San Francisco to Pyramid Harbor, Alaska, and return, on board such vessel as might be designated by the appellant, and to work for the appellant during the fishing season of 1900, at Pyramid Harbor, as sailors and fishermen, agreeing to do “regular ship’s duty, both up and down, discharging and loading; and to do any other work whatsoever when requested to do so by the captain or agent of the Alaska Packers’ Association.” By the terms of this agreement, the appellant was to pay each of the libellants \$50 for the season, and two cents for each red salmon in the catching of which he took part.

On the 15th day of April, 1900, 21 of the libellants signed shipping articles by which they shipped as seamen on the *Two Brothers*, a vessel chartered by the appellant for the voyage between San Francisco and Pyramid Harbor, and also bound themselves to perform the same work for the appellant provided for by the previous contract of March 26th; the appellant agreeing to pay them therefor the sum of \$60 for the season, and two cents each for each red salmon in the catching of which they should respectively take part. Under these contracts, the libellants sailed on board the *Two Brothers* for Pyramid Harbor, where the appellant had about \$150,000 invested in a salmon cannery.

The libellants arrived there early in April of the year mentioned, and began to unload the vessel and fit up the cannery. A few days thereafter, to wit, May 19th,

³ [This case involves contracts for seamen, and it therefore is brought under admiralty jurisdiction in the federal courts. Federal district courts have exclusive jurisdiction under 28 U.S.C. § 1333 over “[a]ny civil case of admiralty or maritime jurisdiction.” Traditionally, an admiralty proceeding was begun by filing a “libel,” which the equivalent of a “complaint” or “petition” in standard civil litigation. The person filing the action—the plaintiff—was called the “libellant.” This case has nothing to do with the tort of libel, and you will confuse about ninety-out-of-a-hundred lawyers if you unwisely say that you are reading a “libel case.” Just call *Alaska Packers* an “admiralty case,” and everyone will be happy. – Eds.]

they stopped work in a body, and demanded of the company's superintendent there in charge \$100 [each] for services in operating the vessel to and from Pyramid Harbor, instead of the sums stipulated for in and by the contracts; stating that unless they were paid this additional wage they would stop work entirely, and return to San Francisco. The evidence showed, and the court below found, that it was impossible for the appellant to get other men to take the places of the libellants, the place being remote, the season short and just opening; so that, after endeavoring for several days without success to induce the libellants to proceed with their work in accordance with their contracts, the company's superintendent, on the 22d day of May, so far yielded to their demands as to instruct his clerk to copy the contracts executed in San Francisco, including the words "Alaska Packers' Association" at the end, substituting, for the \$50 and \$60 payments, respectively, of those contracts, the sum of \$100, which document, so prepared, was signed by the libellants before a shipping commissioner whom they had requested to be brought from Northeast Point.

Upon the return of the libellants to San Francisco at the close of the fishing season, they demanded pay in accordance with the terms of the alleged contract of May 22d, when the company denied its validity, and refused to pay other than as provided for by the contracts of March 26th and April 5th, respectively.

On the trial in the court below, the libellants undertook to show that the fishing nets provided by the respondent were defective, and that it was on that account that they demanded increased wages. On that point, the evidence was substantially conflicting, and the finding of the court was against the libellants, the court saying:

The contention of libellants that the nets provided them were rotten and unserviceable is not sustained by the evidence. The defendant's interest required that libellants should be provided with every facility necessary to their success as fishermen, for on such success depended the profits defendant would be able to realize that season from its packing plant, and the large capital invested therein. In view of this self-evident fact, it is highly improbable that the defendant gave libellants rotten and unserviceable nets with which to fish. It follows from this finding that libellants were not justified in refusing performance of their original contract.

The evidence being sharply conflicting in respect to these facts, the conclusions of the court, who heard and saw the witnesses, will not be disturbed.

The real questions in the case as brought here are questions of law, and, in the view that we take of the case, it will be necessary to consider but one of those. Assuming that the appellant's superintendent at Pyramid Harbor was authorized to make the alleged contract of May 22d, and that he executed it on behalf of the appellant, was it supported by a sufficient consideration?

From the foregoing statement of the case, it will have been seen that the libellants agreed in writing, for certain stated compensation, to render their services to the appellant in remote waters where the season for conducting fishing operations is extremely short, and in which enterprise the appellant had a large amount of money invested; and, after having entered upon the discharge of their contract, and at a time when it was impossible for the appellant to secure other men in their places, the libellants, without any valid cause, absolutely refused to continue the services they were under contract to perform unless the appellant would consent to pay them more money. Consent to such a demand, under such circumstances, if given, was, in our opinion, without consideration, for the reason that it was based solely upon the libellants' agreement to render the exact services, and none other, that they were already under contract to render. The case shows that they willfully and arbitrarily broke that obligation. As a matter of course, they were liable to the appellant in damages, and it is quite probable, as suggested by the court below in its opinion, that they may have been unable to respond in damages. But we are unable to agree with the [district court judge's] conclusions there drawn, from these facts, in these words:

Under such circumstances, it would be strange, indeed, if the law would not permit the defendant to waive the damages caused by the libellants' breach, and enter into the contract sued upon—a contract mutually beneficial to all the parties thereto, in that it gave to the libellants reasonable compensation for their labor, and enabled the defendant to employ to advantage the large capital it had invested in its canning and fishing plant.

The circumstances of the present case bring it, we think, directly within the sound and just observations of the supreme court of Minnesota in the case of *King v. Duluth, M. & N. Ry Co.*, 63 N.W. 1105 (Minn. 1895):

No astute reasoning can change the plain fact that the party who refuses to perform, and thereby coerces a promise from the other party to the contract to pay him an increased compensation for doing that which he is legally bound to do, takes an unjustifiable advantage of the necessities of the other party. There can be no consideration for the promise of the other party, and there is no warrant for inferring that the parties have voluntarily rescinded or modified their contract. The promise cannot be legally enforced, although the other party has completed his contract in reliance upon it.

In *Lingenfelder v. Wainwright Brewing Co.*, 15 S.W. 844 (Mo. 1890), the court, in holding void a contract by which the owner of a building agreed to pay its architect an additional sum because of his refusal to otherwise proceed with the contract, said:

It is urged upon us by respondents that this was a new contract. New in what? Jungenfled was bound by his contract to design and

supervise this building. Under the new promise, he was not to do anything more or anything different. What benefit was to accrue to Wainwright? He was to receive the same service from Jungenfeld under the new, that Jungenfeld was bound to tender under the original, contract. What loss, trouble, or inconvenience could result to Jungenfeld that he had not already assumed? No amount of metaphysical reasoning can change the plain fact that Jungenfeld took advantage of Wainwright's necessities, and extorted the promise of five per cent. on the refrigerator plant as the condition of his complying with his contract already entered into. To permit plaintiff to recover under such circumstances would be to offer a premium upon bad faith, and invite men to violate their most sacred contracts that they may profit by their own wrong.

It is true that as eminent a jurist as Judge Cooley, in *Goebel v. Linn*, 11 N.W. 284 (Mich. 1884), held that an ice company which had agreed to furnish a brewery with all the ice they might need for their business at \$1.75 per ton, and afterwards declined to deliver any more ice unless the brewery would give it \$3 per ton, could recover on a promissory note given for the increased price. Profound as is our respect for the distinguished judge who delivered the opinion, we are still of the opinion that his decision is not in accord with the almost universally accepted doctrine, and is not convincing; and certainly so much of the opinion as holds that the payment, by a debtor, of a part of his debt then due, would constitute a defense to a suit for the remainder, is not the law of this state, nor, do we think, of any other where the common law prevails.

What we hold is that, when a party merely does what he has already obligated himself to do, he cannot demand an additional compensation therefor; and although, by taking advantage of the necessities of his adversary, he obtains a promise for more, the law will regard it as *nudum pactum*, and will not lend its process to aid in the wrong.

It results from the views above expressed that the judgment must be reversed, and the cause remanded, with directions to the court below to enter judgment for the respondent, with costs. It is so ordered.

Review Question 1. If the fishermen had known in advance how this case would come out, what could they have done differently at the time of the dispute to get higher pay *and* have it enforceable against the packing company? Assume that

there was not enough cash on hand at Pyramid Harbor to pay them in advance. Do they have any other viable legal options?

Review Question 2. In her article, *A Fish Story*, 2000 Utah L. Rev. 185, Professor Deborah Threedy researched the history of the *Alaska Packers* case. She concludes that the company *did* deliberately provide faulty nets, because while they needed the fishermen to work the ship to Pyramid Harbor and back, they could buy the salmon from local Alaska natives for less than they had agreed to pay the fishermen. Thus, the more fish caught by the fishermen, the less money the cannery made. If Professor Threedy's conclusion is true—and, more importantly, was found *by the court* to be true—would those facts make a difference in the court's consideration analysis and the outcome of the case? Why or why not?

QUIGLEY v. WILSON

Court of Appeals of Iowa
474 N.W.2d 277 (Iowa Ct. App. 1991)

OXBERGER, C.J.

In 1980 Lester Quigley, Sr. sold his farm on contract to Donald and Janis Wilson. The Wilsons made the installment payments until 1985. In 1985, the Wilsons assigned the contract to Forrest Hatfield. Sometime prior to February 1986, Hatfield informed the Wilsons he could no longer make the payments and returned the farm to them. Donald Wilson then met with Quigley, Sr. to inform him they were also unable to make the upcoming March 1, 1986 payment. After negotiations, Quigley, Sr. and the Wilsons agreed to reduce the contract price along with some other changes from the original contract terms. Both parties signed an agreement dated March 7, 1986, created by Quigley, Sr.'s attorney which reduced their negotiations to writing. Quigley, Sr.'s attorney later recorded the agreement. The Wilsons made all payments due under the 1986 agreement.

Quigley, Sr. is quite elderly and has resided in a nursing home since 1985. In 1988 Quigley, Sr. established a voluntary conservatorship appointing his two children, Lester L. Quigley, Jr. and Veronna Kay Lovell, co-conservators for himself.

The co-conservators filed this lawsuit September 12, 1988, against the Wilsons seeking a declaratory judgment that the Wilsons were in default of the 1980 contract. The Wilsons filed an answer generally denying the claims and asserting the 1986 agreement modified the 1980 contract.

The day before trial the plaintiffs filed a trial brief and motion for partial judgment on the pleadings. They alleged the 1986 agreement was unenforceable due to lack of consideration. The district court overruled the motion finding lack of consideration was not a triable issue.

The case proceeded to trial. The jury found Lester Quigley, Sr. was mentally competent when he entered into the 1986 agreement. The court then held a bench trial on the equitable issues of fraud and undue influence. The court entered a verdict in favor of the Wilsons, finding the 1986 agreement enforceable.

The co-conservators appeal. They contend the issue of lack of consideration should have been submitted to the jury.

We find the case at bar establishes a modification which normally does require consideration. *See Recker v. Gustafson*, 279 N.W.2d 744, 759 (Iowa 1979). In *Recker* which dealt with an oral “modification” to an oral land contract, the court discussed the Iowa law on sufficiency of consideration to support a modification or replacement of a contract. In *Recker* the court quoted the Restatement (Second) of the Law of Contracts § 89, which provides:

A promise modifying a duty under a contract not fully performed on either side is binding

(a) if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made . . .

The *Recker* court also quoted from comment b, Illustration 4 of the Restatement § 89:

The reason for modification must rest in circumstances not “anticipated” as part of the context in which the contract was made, but a frustrating event may be unanticipated for this purpose if it was not adequately covered, even though it was foreseen as a remote possibility. When such a reason is present, the relative financial strength of the parties, the formality with which the modification is made, the extent to which it is performed or relied on and other circumstances may be relevant to show or negate imposition or unfair surprise.

The *Recker* court declined to adopt the Restatement position because no unanticipated circumstances existed in the case other than a desire for more money. However, the court did not discount its application in appropriate circumstances in the future.

We find the case at bar an appropriate circumstance for the adoption of the Restatement’s position. The unanticipated circumstances were the drastic decrease in the value of the land coupled with the seller’s concern about tax repercussions from reacquiring the land and the fact the Wilsons had not received any income from the farm for the previous year. Additionally, the new agreement followed negotiations lasting over a period of time, the document was written by the seller’s attorney, the

trial court found the reduced price was roughly the fair market value of the property at the time the re-negotiations occurred, and the buyers had already paid \$58,000 toward principal on the original contract and the balance of the new contract price was \$62,500. Additionally, we find it significant the jury found Quigley, Sr. was competent when he entered the 1986 agreement and the trial court found no undue influence or fraudulent misrepresentation involved in the agreement. These factors lead us to find this is a situation where it is appropriate to find the modification fair and equitable and does not require proof of additional consideration.

We affirm the trial court's refusal to allow the issue of consideration to be litigated.

Review Question 3. *Quigly* illustrates the Restatement's attitude toward modifications. What "circumstances not anticipated by the parties" would be covered, do you think? And assuming that the parties now disagree about whether it is "fair and equitable," how would a court decide the issue?

MILLS v. WYMAN

Supreme Court of Massachusetts
20 Mass. (3 Pick.) 207 (1825)

This was an action of assumpsit brought to recover a compensation for the board, nursing, &c., of Levi Wyman, son of the defendant, from the 5th to the 20th of February, 1821. The plaintiff then lived at Hartford, in Connecticut; the defendant, at Shrewsbury, in this county. Levi Wyman, at the time when the services were rendered, was about 25 years of age, and had long ceased to be a member of his father's family. He was on his return from a voyage at sea, and being suddenly taken sick at Hartford, and being poor and in distress, was relieved by the plaintiff in the manner and to the extent above stated. On the 24th of February, after all the expenses had been incurred, the defendant wrote a letter to the plaintiff, promising to pay him such expenses. There was no consideration for this promise, except what grew out of the relation which subsisted between Levi Wyman and the defendant, and Howe J., before whom the cause was tried in the Court of Common Pleas, thinking this not sufficient to support the action, directed a nonsuit. To this direction the plaintiff filed exceptions.

PARKER, C. J.

General rules of law established for the protection and security of honest and fair-minded men, who may inconsiderately make promises without any equivalent, will sometimes screen men of a different character from engagements which they are bound *in foro conscientioe* to perform. This is a defect inherent in all human systems of legislation. The rule that a mere verbal promise, without any consideration, cannot be enforced by action, is universal in its application, and cannot be departed from to suit particular cases in which a refusal to perform such a promise may be disgraceful.

The promise declared on in this case appears to have been made without any legal consideration. The kindness and services towards the sick son of the defendant were not bestowed at his request. The son was in no respect under the care of the defendant. He was twenty-five years old, and had long left his father's family. On his return from a foreign country, he fell sick among strangers, and the plaintiff acted the part of the good Samaritan, giving him shelter and comfort until he died. The defendant, his father, on being informed of this event, influenced by a transient feeling of gratitude, promises in writing to pay the plaintiff for the expenses he had incurred. But he has determined to break this promise, and is willing to have his case appear on record as a strong example of particular injustice sometimes necessarily resulting from the operation of general rules.

It is said a moral obligation is a sufficient consideration to support an express promise; and some authorities lay down the rule thus broadly; but upon examination of the cases we are satisfied that the universality of the rule cannot be supported.

If moral obligation, in its fullest sense, is a good substratum for an express promise, it is not easy to perceive why it is not equally good to support an implied promise. What a man ought to do, generally he ought to be made to do, whether he promise or refuse. But the law of society has left most of such obligations to the interior forum, as the tribunal of conscience has been aptly called. Is there not a moral obligation upon every son who has become affluent by means of the education and advantages bestowed upon him by his father, to relieve that father from pecuniary embarrassment, to promote his comfort and happiness, and even to share with him his riches, if thereby he will be made happy? And yet such a son may, with impunity, leave such a father in any degree of penury above that which will expose the community in which he dwells, to the danger of being obliged to preserve him from absolute want. Is not a wealthy father under strong moral obligation to advance the interest of an obedient, well disposed son, to furnish him with the means of acquiring and maintaining a becoming rank in life, to rescue him from the horrors of debt incurred by misfortune? Yet the law will uphold him in any degree of parsimony, short of that which would reduce his son to the necessity of seeking public charity.

Without doubt there are great interests of society which justify withholding the coercive arm of the law from these duties of imperfect obligation, as they are called; imperfect, not because they are less binding upon the conscience than those

which are called perfect, but because the wisdom of the social law does not impose sanctions upon them.

A deliberate promise, in writing, made freely and without any mistake, one which may lead the party to whom it is made into contracts and expenses, cannot be broken without a violation of moral duty. But if there was nothing paid or promised for it, the law, perhaps wisely, leaves the execution of it to the conscience of him who makes it. It is only when the party making the promise gains something, or he to whom it is made loses something, that the law gives the promise validity. And in the case of the promise of the adult to pay the debt of the infant, of the debtor discharged by the statute of limitations or bankruptcy, the principle is preserved by looking back to the origin of the transaction, where an equivalent is to be found. An exact equivalent is not required by the law; for there being a consideration, the parties are left to estimate its value: though here the courts of equity will step in to relieve from gross inadequacy between the consideration and the promise.

A legal obligation is always a sufficient consideration to support either an express or an implied promise; such as an infant's debt for necessaries, or a father's promise to pay for the support and education of his minor children. But when the child shall have attained to manhood, and shall have become his own agent in the world's business, the debts he incurs, whatever may be their nature, create no obligation upon the father; and it seems to follow, that his promise founded upon such a debt has no legally binding force.

The opinions of the judges had been variant for a long course of years upon this subject, but there seems to be no case in which it was nakedly decided, that a promise to pay the debt of a son of full age, not living with his father, though the debt were incurred by sickness which ended in the death of the son, without a previous request by the father proved or presumed, could be enforced by action.

It has been attempted to show a legal obligation on the part of the defendant by virtue of our statute, which compels lineal kindred in the ascending or descending line to support such of their poor relations as are likely to become chargeable to the town where they have their settlement. But it is a sufficient answer to this position, that such legal obligation does not exist except in the very cases provided for in the statute, and never until the party charged has been adjudged to be of sufficient ability thereto. We do not know from the report any of the facts which are necessary to create such an obligation. Whether the deceased had a legal settlement in this commonwealth at the time of his death, whether he was likely to become chargeable had he lived, whether the defendant was of sufficient ability, are essential facts to be adjudicated by the court to which is given jurisdiction on this subject. The legal liability does not arise until these facts have all been ascertained by judgment, after hearing the party intended to be charged.

For the foregoing reasons we are all of opinion that the nonsuit directed by the Court of Common Pleas was right, and that judgment be entered thereon for costs for the defendant.

Review Question 4. Isn't this exactly the same situation as the hypothetical in *Style v. Smith*, mentioned in the introduction to this unit? Can you distinguish the two? Would it make a difference if the son in *Style* were a minor living in his father's home?

Review Question 5. In a later English case, *Eastwood v. Kenyon*, 113 Eng. Rep. 482 (K.B. 1840), Lord Chief Justice Denman suggested that enforcing gratuitous promises was not a great idea:

The enforcement of such [gratuitous] promises by law, however plausibly reconciled by the desire to effect all conscientious engagements, might be attended with mischievous consequences to society; one of which would be the frequent preference of voluntary undertakings to claims for just debts. Suits would thereby be multiplied, and voluntary undertakings would also be multiplied, to the prejudice of real creditors. The temptations of executors would be much increased by the prevalence of such a doctrine, and the faithful discharge of their duty be rendered more difficult.

What "mischievous consequences" can you imagine arising from enforcing gratuitous promises? Is there anything wrong with a bright-line rule that people are legally obliged to pay whatever they have promised to pay?

HARRINGTON v. TAYLOR
Supreme Court of North Carolina
225 N.C. 690, 36 S.E.2d 227 (1945)

PER CURIAM

The plaintiff in this case sought to recover of the defendant upon a promise made by him under the following peculiar circumstances:

The defendant had assaulted his wife, who took refuge in plaintiff's house. The next day the defendant gained access to the house and began another assault upon his wife. The defendant's wife knocked him down with an axe, and was on the point of cutting his head open or decapitating him while he was laying on the floor, and the plaintiff intervened, caught the axe as it was descending, and the blow intended for defendant fell upon her hand, mutilating it badly, but saving defendant's life.

Subsequently, defendant orally promised to pay the plaintiff her damages; but, after paying a small sum, failed to pay anything more. So, substantially, states the complaint.

The defendant demurred to the complaint as not stating a cause of action, and the demurrer was sustained. Plaintiff appealed.

The question presented is whether there was a consideration recognized by our law as sufficient to support the promise. The Court is of the opinion that however much the defendant should be impelled by common gratitude to alleviate the plaintiff's misfortune, a humanitarian act of this kind, voluntarily performed, is not such consideration as would entitle her to recover at law.

The judgment sustaining the demurrer is
Affirmed.

Review Question 5. The facts of *Harrington* seem pretty straightforward. Harrington saved Taylor's life gratuitously, so the subsequent promise lacked consideration. As you read the next case, consider whether it is equally straightforward and should reach the same result.

WEBB v. McGOWIN

Court of Appeals of Alabama

27 Ala. App. 82, 168 So. 196 (1935), aff'd 232 Ala. 374, 168 So. 199 (1936)

BRICKEN, P.J.

A fair statement of the case presenting the questions for decision is set out in appellant's brief, which we adopt.

On the 3d day of August, 1925, appellant [Joe Webb] while in the employ of the W.T. Smith Lumber Company, a corporation, and acting within the scope of his employment, was engaged in clearing the upper floor of mill No. 2 of the company. While so engaged he was in the act of dropping a pine block from the upper floor of the mill to the ground below; this being the usual and ordinary way of clearing the floor, and it being the duty of the plaintiff in the course of his employment to so drop it. The block weighed about 75 pounds.

As appellant was in the act of dropping the block to the ground below, he was on the edge of the upper floor of the mill. As he started to turn the block loose so that it would drop to the ground, he saw J. Greeley McGowin, testator of the defendants [and president of the company], on the ground below and directly under where the block would have fallen had appellant turned it loose. Had he turned it loose it would have struck McGowin with such force as to have caused him serious bodily harm or death. Appellant could have remained safely on the upper floor of the mill by turning the block loose and allowing it to drop, but had he done this the block would have fallen on McGowin and caused him serious injuries or death. The only safe and reasonable way to prevent this was for appellant to hold to the block and divert its direction in falling from the place where McGowin was standing and the only safe way to divert it so as to prevent its coming into contact with McGowin was for appellant to fall with it to the ground below. Appellant did this, and by holding to the block and falling with it to the ground below, he diverted the course of its fall in such way that McGowin was not injured. In thus preventing the injuries to McGowin appellant himself received serious bodily injuries, resulting in his right leg being broken, the heel of his right foot torn off and his right arm broken. He was badly crippled for life and rendered unable to do physical or mental labor.

On September 1, 1925, in consideration of appellant having prevented him from sustaining death or serious bodily harm and in consideration of the injuries appellant had received, McGowin agreed with him to care for and maintain him for the remainder of appellant's life at the rate of \$15 [about \$800 today] every two weeks from the time he sustained his injuries to and during the remainder of appellant's life; it being agreed that McGowin would

pay this sum to appellant for his maintenance. Under the agreement McGowin paid or caused to be paid to appellant the sum so agreed on up until McGowin's death on January 1, 1934. After his death the payments were continued to and including January 27, 1934, at which time they were discontinued. Thereupon plaintiff brought suit to recover the unpaid installments accruing up to the time of the bringing of the suit.

The material averments of the different counts of the original complaint and the amended complaint are predicated upon the foregoing statement of facts.

In other words, the complaint as amended averred in substance: (1) That on August 3, 1925, appellant saved J. Greeley McGowin, appellee's testator, from death or grievous bodily harm; (2) that in doing so appellant sustained bodily injury crippling him for life; (3) that in consideration of the services rendered and the injuries received by appellant, McGowin agreed to care for him the remainder of appellant's life, the amount to be paid being \$15 every two weeks; (4) that McGowin complied with this agreement until he died on January 1, 1934, and the payments were kept up to January 27, 1934, after which they were discontinued.

The action was for the unpaid installments accruing after January 27, 1934, to the time of the suit. [The trial court sustained a demurrer to Webb's complaint, and Webb appealed.]

The principal grounds of demurrer to the original and amended complaint are: (1) It states no cause of action; (2) its averments show the contract was without consideration; (3) it fails to allege that McGowin had, at or before the services were rendered, agreed to pay appellant for them.

The averments of the complaint show that appellant saved McGowin from death or grievous bodily harm. This was a material benefit to him of infinitely more value than any financial aid he could have received. Receiving this benefit, McGowin became morally bound to compensate appellant for the services rendered. Recognizing his moral obligation, he expressly agreed to pay appellant as alleged in the complaint and complied with this agreement up to the time of his death; a period of more than 8 years.

Had McGowin been accidentally poisoned and a physician, without his knowledge or request, had administered an antidote, thus saving his life, a subsequent promise by McGowin to pay the physician would have been valid. Likewise, McGowin's agreement as disclosed by the complaint to compensate appellant for saving him from death or grievous bodily injury is valid and enforceable.

Where the promisee cares for, improves, and preserves the property of the promisor, though done without his request, it is sufficient consideration for the promisor's subsequent agreement to pay for the service, because of the material

benefit received. *Pittsburg Vitrified Paving & Building Brick Co. v. Cerebus Oil Co.*, 100 P. 631 (Kan. 1909); *Edson v. Poppe*, 124 N.W. 441 (S.D. 1910); *Drake v. Bell*, 55 N.Y.S. 945 (N.Y. Sup. Ct. 1899).

In *Boothe v. Fitzpatrick*, 36 Vt. 681 (1864), the court held that a promise by defendant to pay for the past keeping of a bull which had escaped from defendant's premises and been cared for by plaintiff was valid, although there was no previous request, because the subsequent promise obviated that objection; it being equivalent to a previous request. On the same principle, had the promisee saved the promisor's life or his body from grievous harm, his subsequent promise to pay for the services rendered would have been valid. Such service would have been far more material than caring for his bull. Any holding that saving a man from death or grievous bodily harm is not a material benefit sufficient to uphold a subsequent promise to pay for the service, necessarily rests on the assumption that saving life and preservation of the body from harm have only a sentimental value. The converse of this is true. Life and preservation of the body have material, pecuniary values, measurable in dollars and cents. Because of this, physicians practice their profession charging for services rendered in saving life and curing the body of its ills, and surgeons perform operations. The same is true as to the law of negligence, authorizing the assessment of damages in personal injury cases based upon the extent of the injuries, earnings, and life expectancies of those injured.

In the business of life insurance, the value of a man's life is measured in dollars and cents according to his expectancy, the soundness of his body, and his ability to pay premiums. The same is true as to health and accident insurance.

It follows that if, as alleged in the complaint, appellant saved J. Greeley McGowin from death or grievous bodily harm, and McGowin subsequently agreed to pay him for the service rendered, it became a valid and enforceable contract.

It is well settled that a moral obligation is a sufficient consideration to support a subsequent promise to pay where the promisor has received a material benefit, although there was no original duty or liability resting on the promisor. *Lycoming County v. Union County*, 15 Pa. 166 (1850); *Ferguson v. Harris*, 17 S.E. 782 (S.C. 1893); *Muir v. Kane*, 104 P. 153 (Wash. 1909); *Hawkes v. Saunders*, 98 Eng. Rep. 1091 (K.B. 1782).

In the case of *State ex rel. Bayer v. Funk*, 199 P. 592 (Ore. 1921), the court held that a moral obligation is a sufficient consideration to support an executory promise where the promisor has received an actual pecuniary or material benefit for which he subsequently expressly promised to pay.

Some authorities hold that, for a moral obligation to support a subsequent promise to pay, there must have existed a prior legal or equitable obligation, which for some reason had become unenforceable, but for which the promisor was still morally bound. This rule, however, is subject to qualification in those cases where the

promisor, having received a material benefit from the promisee, is morally bound to compensate him for the services rendered and in consideration of this obligation promises to pay. In such cases the subsequent promise to pay is an affirmance or ratification of the services rendered carrying with it the presumption that a previous request for the service was made. *McMorris v. Herndon*, 18 S.C.L. (2 Bail.) 56 (1820); *Chadwick v. Knox*, 31 N.H. 226 (1855); *Kenan v. Holloway*, 16 Ala. 53 (1849); *Ross v. Pearson*, 21 Ala. 473 (1852).

The case at bar is clearly distinguishable from that class of cases where the consideration is a mere moral obligation or conscientious duty unconnected with receipt by promisor of benefits of a material or pecuniary nature. *Park Falls State Bank v. Fordyce*, 238 N.W. 516 (Wis. 1932). Here the promisor received a material benefit constituting a valid consideration for his promise.

Under the decisions above cited, McGowin's express promise to pay appellant for the services rendered was an affirmance or ratification of what appellant had done raising the presumption that the services had been rendered at McGowin's request.

The cases of *Shaw v. Boyd*, 1 Stew. & P. 83 (Ala. 1831), and *Duncan v. Hall*, 9 Ala. 128 (1846), are not in conflict with the principles here announced. In those cases the lands were owned by the United States at the time the alleged improvements were made, for which subsequent purchasers from the government agreed to pay. These subsequent purchasers were not the owners of the lands at the time the improvements were made. Consequently, they could not have been made for their benefit.

The averments of the complaint show that in saving McGowin from death or grievous bodily harm, appellant was crippled for life. This was part of the consideration of the contract declared on. McGowin was benefitted. Appellant was injured. Benefit to the promisor or injury to the promisee is a sufficient legal consideration for the promisor's agreement to pay. *Fisher v. Bartlett*, 8 Greenl. 122, 22 Am. Dec. 225.

From what has been said, we are of the opinion that the court below erred in the ruling complained of; that is to say, in sustaining the demurrer, and for this error the case is reversed and remanded.

Reversed and remanded.

Review Question 6. In affirming the court of appeals, the Alabama Supreme Court emphasized “the distinction between a supposed moral obligation of the promisor, based upon some refined sense of ethical duty, without material benefit to him, and one in which such a benefit did in fact occur.” If Webb had saved the life of

McGowin’s adult child, would that have been a “material” benefit? Or would the case fall under *Mills v. Wyman*?

Review Question 7. Mrs. Harrington saved a man from being hit by an axe wielded by an angry third party. She lost. Mr. Webb simply stopped dropping a heavy block on a man. He won. Can you reconcile the two cases? If so, how?

Review Question 8. Suppose McGowin, when he saw Webb fall, instead said, “Webb, you clumsy oaf, you almost hit me! Next time, be more careful—you’re getting blood on my shoes!” Instead of promising to pay Webb, McGowin demands that he pay to remove the stains from the leather. Does McGowin owe anything to Webb? If not, why is it different if he just acts like a nice guy and makes a promise?

Problems

Problem 8.1

John is a student who is just about to graduate from medical school. During medical school he has lived with his long-time girlfriend, Mary, a bookkeeper who has paid most of his living expenses during the previous three-years. At a party to celebrate his graduation, John stands up in front of Mary and a group of friends, and thanks her for all of her support: “Without her financial support, I couldn’t have even made it through, and without her emotional support I wouldn’t have been able to succeed the way I have.” To general applause, John continues, “I know that Mary has always dreamed about going to law school, and I want to thank her for everything she’s done for me. So in front of you all, I promise that I will support her the way she supported me, and I’ll pay all of her expenses in law school just the way she paid mine.” Mary starts to cry, because this was totally unexpected. Everyone hugs each other. Mary starts thinking seriously about going to school.

Three months later, John meets Elise and leaves Mary. When Mary asks John to keep his promise, he refuses. Is John’s promise to Mary legally enforceable?

Problem 8.2

Mona was hired to work at a hospital as an at-will employee. Several days after she started work, she was called into the Human Resources office to do the necessary paperwork. As part of that process, she signed a variety of documents. The documents included the following:

I agree to the grievance and arbitration provisions set forth in the Associates Policy Manual. I understand that I am waiving my right to a trial, including a jury trial, in state or federal court of the class of

disputes specifically set forth in the grievance and arbitration provisions on pages 8-10 of the Manual.

Later that day, she was given a copy of the Manual. It provided that if an employee claimed a violation of anti-discrimination law by the hospital,

THEN IT IS CLEARLY INTENDED AND AGREED THAT THE SOLE AND EXCLUSIVE MEANS FOR THE RESOLUTION OF ALL DISPUTES, ISSUES, CONTROVERSIES, CLAIMS, CAUSES OF ACTION OR GRIEVANCES BY AN EMPLOYEE AGAINST NEIGHBORHOOD HEALTH CLINICS SHALL BE THROUGH THE PROCESS OF ARBITRATION AND PURSUANT TO THE INDIANA UNIFORM ARBITRATION ACT.

The opening two paragraphs of the Manual include the following language:

[The hospital] reserves the right at any time to modify, revoke, suspend, terminate, or change any or all terms of this Manual, plans, policies, or procedures, in whole or in part, without having to consult or reach agreement with anyone, at any time, with or without notice.

While [the hospital] intends to abide by the policies and procedures described in this Manual, it does not constitute a contract nor promise of any kind. Therefore, employees can be terminated at any time, with or without notice, and with or without cause.

Mona was subsequently fired and sued for discrimination in federal court. The hospital moved to dismiss the suit and refer it to arbitration. Mona argued that there was no consideration for her agreement to the new policy because she had already started work before she signed it. What result?

Problem 8.3

Kümmerbünd is a relatively unknown musical group, which has agreed to play a concert at Club Now, a popular music venue, for a flat fee of \$2,500. After the contract is signed, but several weeks before the performance, Kümmerbünd is suddenly catapulted to fame with the success of a new single, "Smell the Glove," a cover version of an old Spinal Tap song. Kümmerbünd now has many offers to perform at much higher prices. Kümmerbünd calls Club Now and says that it will not perform unless the payment is increased to \$10,000. Club Now at first tries to insist on the original deal, but finally gives up and agrees to pay \$10,000.

On the night of the concert, Club Now triples the cover-charge and sells out every seat, clearing \$25,000 in profit. When Kümmerbünd asks for payment, Club Now gives them a check for \$2,500. Kümmerbünd demands the remainder. Club Now

refuses, saying, “We had a deal.” Kümmerbünd sues. Should the band be able to receive the extra \$7,500 in compensation? Why or why not?

Problem 8.4

The Poplars is a beautiful and historic old mansion that is very popular with prospective brides as a site for their weddings. Peach (a rich debutante) and Mario are going to be married, and Peach wants to have the event at The Poplars. She wants to be married August 1.

The Poplars, however, is undergoing some remodeling, which would interfere with the wedding. That work is supposed to be finished by July 25, just in time for Peach’s wedding to go off without a hitch. But the contractor, Yoshi, is running a little behind. Yoshi repeatedly asserts that the project will be by July 25, but both the management of The Poplars and Peach are dubious.

To ensure that the remodeling will not disrupt her wedding, Peach (who has no other connection to The Poplars except that she wants to have her wedding there) on her own offers Yoshi a \$10,000 bonus if all work is done on The Poplars by July 25, the date required by his contract with The Poplars. Spurred by this promise, Yoshi lays on some extra help and finishes the work on time. Peach and Mario’s wedding is held, and is a terrific success.

Peach, however, never pays the \$10,000. Yoshi sues, demanding payment. Can Yoshi recover the money from Peach?

Unit 9: Promissory Estoppel as a Consideration Substitute

CONSIDERATION Part Three

FOCUS OF THIS UNIT

If you have found the requirement of consideration to be prone to occasional injustice, you are not alone. Courts have wrestled with the issue of avoiding injustice in some situations where parties have an enforceable contract, except for its lack of consideration. In this unit, you will learn about one of the most important vehicles for enforcing such agreements, the doctrine of *promissory estoppel*. A proper understanding of promissory estoppel, however, requires that we begin with a brief diversion into its origins in the broader concept of equitable estoppel. The easiest way to do that is to tell you a story. Grab some popcorn and listen closely.

The Plight of Farmer Giles. Suppose back in the 15th century—a time when property lines were rather hazy given the lack of a good recording system—Farmer Giles, a prosperous freeholder, wants to dig a new well for his flocks. His land is adjacent to that of a local magnate, Lord Blicester. Giles talks with Lord Blicester, who tells him that the boundary line between the two properties lays along a particular line of trees. Giles, relying on the lord’s statement, goes ahead and digs the well on what he thinks is his side of the property line. When it is finished, however, Lord Blicester laughs, slaps his knee, and explains that the boundary line is actually six rods *west* of the tree line, so the new well is on the lord’s property. Giles is thrown off the property and cannot use the well.

The English courts, faced with situations like this—where one party had relied on a false statement of fact made by another—invented a doctrine to deal with the problem. In the law-French used in English courts in those days, it was called “estoppel.” The word comes from the Anglo-French *estopper*, which meant “stop up” (as with a bottle) or “close” (as with a door). Thus, the word “estop” means, quite literally, “shut up.”

If You're Not *Allowed* to Prove It, Then Guess What Happens. In Farmer Giles's case, he might set his sheep onto Lord Blicester's land to use the well. The lord, in response, would try to assert that the well was on the lord's property and thus Giles had no right to use it. But the judges, if they believed Giles, would, in effect (and in prettier language), tell Lord Blicester to *shut up*. He would simply be forbidden to argue that the well was on his property.¹ The proceedings would go something like this (translated very loosely from the law French of the period):

BLICESTER: Your honor, the well is on my land so I have a right to exclude Giles from using it. A man's castle is his home.

JUDGE: Well, yes, but you tricked him into digging it on your property by lying to him, didn't you?

BLICESTER: So what? It isn't my fault that some of the peasants aren't the sharpest needles in the haystack.

JUDGE: So . . . that was a pretty *bad* thing you did. You're a *bad* person to try and take advantage of your neighbor.

BLICESTER: "Sticks and stones will break my bones." There's no law against lying to your neighbor, is there?

JUDGE: Well, no.

BLICESTER: And a man has the legal right to throw people off his own property, doesn't he?

JUDGE: Yes.

BLICESTER: So why aren't we done? I obviously win.

JUDGE: Not so fast. To throw him off your land, you have to be able to prove that it *is* your land, don't you?

BLICESTER: Sure. But I can prove that easily, because here's my deed to the property that lays the boundaries out correctly. It's all straight from the Earl himself. That's his "X" right there on the

¹ [If you think it unrealistic that a royal courts in the 15th century would rule for a farmer against a nobleman, then think again. Don't erroneously assume that rich people all make up a single class with similar interests. A concern of the Crown in many European countries during this period was to cut away at the power of the nobility who had their own armies, their own personal courts, and a nasty habit of rebelling every few decades. Increasing the power of rising freedmen and peasants against nobles served as a means to suppress the relative power of the nobles and reduce their financial resources. Of course, the Crown was not nearly so enthusiastic about increasing the power of freedmen and peasants against the Crown itself. The moral of the story is that you sometimes you need a scorecard to tell who is doing what to whom and why.—Eds.]

signature line, and his wax seal. I have the scribes and the surveyors here to testify.

JUDGE [pretends to cover ears]: La-la-la-laaa! I can't hear you.

BLICESTER: What?

JUDGE [covers eyes]: And I can't see your deed.

BLICESTER: What are you talking about?

JUDGE [uncovers his eyes]: I'm sorry, you have to prove the well is on your land, and you can't prove it.

BLICESTER: Yes, I can. Here's the blinking *deed*! It's signed by the blooming *Earl*!

JUDGE: Ah, yes. If I *listened* to what you said and *looked* at the deed, you'd win.

BLICESTER: That's what I'm saying!

JUDGE: So I won't.

BLICESTER: You won't what?

JUDGE: Listen to you or look at your proof.

BLICESTER: But you have to!

JUDGE: I don't *have* to do anything. I'm a *judge*.

BLICESTER: What?

JUDGE: [Patiently] Here, you're not a lawyer, my lord. Let me explain. To prove that the property is on your land, you'd have to swear that it's your land and show me the deed. In order for me to *officially* recognize your testimony and your documents, I have to enter them into *evidence* before me, right?

BLICESTER: I suppose so.

JUDGE: Now, think hard. *I'm* the judge. *Who* decides whether things are going to be admitted into evidence before *me*?

BLICESTER: Uh . . . you?

JUDGE: Nicely done! Me. So follow this carefully. [*Illustrates points by raising fingers one by one.*] *One*, you will prove your case if your testimony and evidence are admitted. But *two*, to prove the case you have to get your evidence admitted. *Three*, I am not going to admit your evidence because you are a bad person who lied, and you shouldn't be rewarded for your own evil acts. That would be *inequitable*. *Four*, since

you have failed to place any admissible evidence before me, you haven't proved it's your land. And *five*, since you have no right to throw anyone off property that isn't yours, Farmer Giles wins.

BLICESTER: That's crazy.

JUDGE: No, that's *estoppel*. When you lie and then try to take advantage of it in a court, we judges will use our inherent *equitable* powers to prevent ourselves from helping you do it. We do that by making you shut up.

BLICESTER: But the proof is right here!

JUDGE [hammers gavel]: Shut up. Bailiff, see his lordship out. Next case!

Equity Says You Can't Have It Both Ways. This "equitable" power of judges makes a good deal of sense. It's one thing for someone to cheat another. It's something very different for courts to *help* someone use the law to cheat. Where one party has lied and tries to take advantage of that lie, he or she will be estopped to contradict the previous lie.

Over time, however, the doctrine of estoppel—originally called "*estoppel in pais*" (roughly, "estoppel by your own conduct"), became broader. There began to be categories, such as estoppel by deed, estoppel by record, and estoppel by silence, but all of these ultimately came to be categorized, in American law, as "equitable estoppel." Judges began to apply the principle to situations in which the speaker did not deliberately lie, but was merely negligent about the truth. Finally, the principle came to be applied even in situations where the facts turned out to be untrue even though the speaker was acting entirely in good faith. All of these forms of equitable estoppel, however, applied only to *statements of fact*, not to *promises*.

Reliance on What? People do, however, rely on many statements that are not facts, including opinions, predictions, and promises. When *A* makes a promise to *B*, *B* might well rely on that promise. If the promise is in the form of a *contract*, reliance by the promisee is reasonable due to the promise being enforceable at law. If the promise is made by someone you trust, reliance may be reasonable based on that trust relationship. But what if you rely on a promise from someone you hardly know, and it is *not* the kind of exchange transaction we saw in our consideration cases? Will the law enforce a promise just because you relied on it?

The answer, perhaps surprisingly, is yes—sometimes. Because the doctrine of equitable estoppel requires a false statement of *fact*, judges developed a new doctrine based on an unkept promise and called it "promissory estoppel." Rather than basing the enforceability of a promise on the presence or absence of consideration, promissory estoppel is grounded in the concept of reliance.

Promissory Estoppel Is Something, But Not Everything. After suffering through the study of consideration and its technicalities, many law students become overly attached to promissory estoppel, viewing it as a solution for every injustice that occurs based on the absence of an otherwise enforceable contract. The doctrine, however, is not that broad, and also does not necessarily replicate the remedies that are available for enforcement of a true contract. As you read the cases and materials in this unit, watch carefully for the specific factual scenarios in which courts are willing to allow the use of promissory estoppel.

Read section 90 of the Restatement (Second) of Contracts before you continue with this unit.

Cases and Materials

RICKETTS v. SCOTHORN

Supreme Court of Nebraska
57 Neb. 51, 77 N.W. 365 (1898)

SULLIVAN, J.

In the district court of Lancaster county the plaintiff Katie Scothorn recovered judgment against the defendant Andrew D. Ricketts, as executor of the last will and testament of John C. Ricketts, deceased. The action was based upon a promissory note, of which the following is a copy:

May the first, 1891

I promise to pay to Katie Scothorn on demand, \$ 2,000,
to be at 6 per cent per annum.

J. C. RICKETTS.

The material facts are undisputed. They are as follows: John C. Ricketts, the maker of the note, was the grandfather of the plaintiff. Early in May—presumably on the day the note bears date—he called on her at the store where she was working. What transpired between them is thus described by Mr. Flodene, one of the plaintiff's witnesses:

A. Well the old gentleman came in there one morning about 9 o'clock—probably a little before or a little after, but early in the morning—and he unbuttoned his vest and took out a piece of paper in the shape of a note; that is the way it looked to me; and he says to Miss

Scothorn, “I have fixed out something that you have not got to work any more.” He says, “None of my grandchildren work and you don’t have to.”

Q. Where was she?

A. She took the piece of paper and kissed him; and kissed the old gentleman and commenced to cry.

It seems Miss Scotthorn immediately notified her employer of her intention to quit work and that she did soon after abandon her occupation. The mother of the plaintiff was a witness and testified that she had a conversation with her father, Mr. Ricketts, shortly after the note was executed in which he informed her that he had given the note to the plaintiff to enable her to quit work; that none of his grandchildren worked and he did not think she ought to. For something more than a year the plaintiff was without an occupation; but in September, 1892, with the consent of her grandfather, and by his assistance, she secured a position as bookkeeper with Messrs. Funke & Ogden. On June 8, 1894, Mr. Ricketts died. He had paid one year’s interest on the note, and a short time before his death expressed regret that he had not been able to pay the balance. In the summer or fall of 1892 he stated to his daughter, Mrs. Scotthorn, that if he could sell his farm in Ohio he would pay the note out of the proceeds. He at no time repudiated the obligation. We quite agree with counsel for the defendant that upon this evidence there was nothing to submit to the jury, and that a verdict should have been directed peremptorily for one of the parties. The testimony of Flodene and Mrs. Scotthorn, taken together, conclusively establishes the fact that the note was not given in consideration of the plaintiff pursuing, or agreeing to pursue, any particular line of conduct. There was no promise on the part of the plaintiff to do or refrain from doing anything. Her right to the money promised in the note was not made to depend upon an abandonment of her employment with Mayer Bros. and future abstention from like service. Mr. Ricketts made no condition, requirement, or request. He exacted no *quid pro quo*. He gave the note as a gratuity and looked for nothing in return. So far as the evidence discloses, it was his purpose to place the plaintiff in a position of independence where she could work or remain idle as she might choose. The abandonment by Miss Scotthorn of her position as bookkeeper was altogether voluntary. It was not an act done in fulfillment of any contract obligation assumed when she accepted the note. The instrument in suit being given without any valuable consideration, [it] was nothing more than a promise to make a gift in the future of the sum of money therein named. Ordinarily, such promises are not enforceable even when put in the form of a promissory note.²

² [This particular statement about promissory notes not being enforceable absent consideration is not fully a reflection of current law. Certain holders of promissory notes, those known as “holders in due course,” are able to enforce a promissory note (a particular form of written promise to pay money) even if the note is not supported by consideration. *See generally* UNIFORM COMMERCIAL CODE § 3-305. You can learn more about the ins and outs of promissory notes and other negotiable instruments—all a peculiar species of contract law—in an upper level law school course sometimes known as Payment Systems, Negotiable Instruments, or Commercial Law. – Eds.]

Kirkpatrick v. Taylor, 43 Ill. 207 (1867); *Johnston v. Griest*, 85 Ind. 503 (1882); *Fink v. Cox*, 18 Johns. 145 (N.Y. 1820).

But it has often been held that an action on a note given to a church, college, or other like institution, upon the faith of which money has been expended or obligations incurred, could not be successfully defended on the ground of a want of consideration. *Barnes v. Perine*, 12 N.Y. 18 (1854); *Philomath College v. Hartless*, 6 Ore. 158 (1876); *Thompson v. Mercer County*, 40 Ill. 379 (1866); *Irwin v. Lombard University*, 46 N.E. 63 (Ohio 1897). In this class of cases the note in suit is nearly always spoken of as a gift or donation, but the decision is generally put on the ground that the expenditure of money or assumption of liability by the donee, on the faith of the promise, constitutes a valuable and sufficient consideration. It seems to us that the true reason is the preclusion of the defendant, under the doctrine of estoppel, to deny the consideration. Such seems to be the view of the matter taken by the supreme court of Iowa in the case of *Simpson Centenary College v. Tuttle*, 33 N.W. 74 (Iowa 1887), where Rothrock, J., speaking for the court, said:

Where a note, however, is based on a promise to give for the support of the objects referred to, it may still be open to this defense [want of consideration], unless it shall appear that the donee has, prior to any revocation, entered into engagements or made expenditures based on such promise, so that he must suffer loss or injury if the note is not paid. This is based on the equitable principle that, after allowing the donee to incur obligations on the faith that the note would be paid, the donor would be estopped from pleading want of consideration.

When the [promisee] changes his position to his disadvantage, in reliance on the promise, a right of action does arise. *McClure v. Wilson*, 43 Ill. 356 (1867)

Under the circumstances of this case is there an equitable estoppel which ought to preclude the defendant from alleging that the note in controversy is lacking in one of the essential elements of a valid contract? We think there is. An *estoppel in pais* is defined to be “a right arising from acts, admissions, or conduct which have induced a change of position in accordance with the real or apparent intention of the party against whom they are alleged.” Mr. Pomeroy has formulated the following definition:

Equitable estoppel is the effect of the voluntary conduct of a party whereby he is absolutely precluded, both at law and in equity, from asserting rights which might perhaps have otherwise existed, either of property, or contract, or of remedy, as against another person who in good faith relied upon such conduct, and has been led thereby to change his position for the worse, and who on his part acquires some corresponding right either of property, of contract, or of remedy.

2 JOHN NORTON POMEROY, JR., A TREATISE ON EQUITY JURISPRUDENCE AND EQUITABLE REMEDIES 804 (2d ed. 1892).

According to the undisputed proof, as shown by the record before us, the plaintiff was a working girl, holding a position in which she earned a salary of \$10 per week. Her grandfather, desiring to put her in a position of independence, gave her the note, accompanying it with the remark that his other grandchildren did not work, and that she would not be obliged to work any longer. In effect he suggested that she might abandon her employment and rely in the future upon the bounty which he promised. He, doubtless, desired that she should give up her occupation, but whether he did or not, it is entirely certain that he contemplated such action on her part as a reasonable and probable consequence of his gift. Having intentionally influenced the plaintiff to alter her position for the worse on the faith of the note being paid when due, it would be grossly inequitable to permit the maker, or his executor, to resist payment on the ground that the promise was given without consideration. The petition charges the elements of an equitable estoppel, and the evidence conclusively establishes them. If errors intervened at the trial they could not have been prejudicial. A verdict for the defendant would be unwarranted. The judgment is right and is

AFFIRMED.

Review Question 1. We have already seen that this kind of note does not constitute a gift (because there was no delivery of the money) or a contract (because Katie provided no consideration). So if it's not enforceable, why exactly is it reasonable to *rely* on it? Does the court really mean that a promise of a gift is enforceable if I rely on it?

Review Question 2. Suppose Katie had a twin sister named Sadie who received the same promise from their grandfather. Instead of giving up her job and “working girl” social status, however, Sadie decided to keep working and put the money from her grandfather into savings. Would Sadie be able to enforce the promise upon which she had not actually relied? If not, why does Katie, who quit her job to live off an inheritance, get the money while the hard-working and more cautious Sadie does not. What social benefit, if any, is the doctrine of estoppel actually accomplishing? Is estoppel fair? Is abstract fairness something we should care one way or the other?

HOFFMAN v. RED OWL STORES, INC.

Supreme Court of Wisconsin
26 Wis. 2d 683, 133 N.W.2d 267 (1965)

CURRIE, C.J.

[Joseph Hoffman owned and operated an independent bakery. He decided he wanted to go into the larger and more complex grocery-store business. Red Owl Stores was a grocery store company that sold franchises to operate locally-owned “Red Owl” markets. Hoffman began negotiations with Red Owl, and was assured by Red Owl employees that they would be able to put him in a store for an \$18,000 investment. No contract was ever signed between the parties. On Red Owl’s advice, he sold his bakery and bought another grocery store to get experience in the business. He then sold that store so he would be eligible for a Red Owl franchise, and he then went to work temporarily for another bakery. At this point, negotiations bogged down over how much money Hoffman would be required to invest in the new business. Ultimately, no contract was reached because the parties could not agree on how much Hoffman had to invest. The jury found that Red Owl had represented to Hoffman that \$18,000 would be sufficient, and that Hoffman had relied on that representation in selling first his bakery and then his grocery store. The jury assessed damages against Red Owl based on a theory of promissory estoppel.]

The instant appeal and cross appeal present these questions: (1) Whether this court should recognize causes of action grounded on promissory estoppel as exemplified by Restatement of Contracts § 90? (2) Do the facts in this case make out a cause of action for promissory estoppel?

Section 90 provides :

A promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.”

The Wisconsin Annotations to Restatement, Contracts, prepared under the direction of the late Professor William H. Page and issued in 1933, stated:

The Wisconsin cases do not seem to be in accord with this section of the Restatement. It is certain that no such proposition has ever been announced by the Wisconsin court and it is at least doubtful if it would be approved by the court.

Since 1933, the closest approach this court has made to adopting the rule of the Restatement occurred in the recent case of *Lazarus v. American Motors Corp.*, 123 N.W.2d 548 (Wis. 1963), wherein the court stated:

We recognize that upon different facts it would be possible for a seller of steel to have altered his position so as to effectuate the equitable considerations inherent in sec. 90 of the Restatement.

While it was not necessary to the disposition of the *Lazarus* case to adopt the promissory-estoppel rule of the Restatement, we are squarely faced in the instant case with that issue.

Many courts of other jurisdictions have seen fit over the years to adopt the principle of promissory estoppel, and the tendency in that direction continues. As Mr. Justice McFaddin, speaking in behalf of the Arkansas court, well stated, the development of the law of promissory estoppel “is an attempt by the courts to keep remedies abreast of increased moral consciousness of honesty and fair representations in all business dealings.” *Peoples National Bank of Little Rock v. Linebarger Construction Co.*, 240 S.W.2d 12 (Ark. 1951).

Because we deem the doctrine of promissory estoppel, as stated in § 90 is one which supplies a needed tool which courts may employ in a proper case to prevent injustice, we endorse and adopt it.

The record here discloses a number of promises and assurances given to Hoffman by [Red Owl employee] Lukowitz in behalf of Red Owl upon which plaintiffs relied and acted upon to their detriment.

Foremost were the promises that for the sum of \$18,000 Red Owl would establish Hoffman in a store. After Hoffman had sold his grocery store and paid the \$1,000 on the Chilton lot, the \$18,000 figure was changed to \$24,100. Then in November, 1961, Hoffman was assured that if the \$24,100 figure were increased by \$2,000 the deal would go through. Hoffman was induced to sell his grocery store fixtures and inventory in June, 1961, on the promise that he would be in his new store by fall. In November, plaintiffs sold their bakery building on the urging of defendants and on the assurance that this was the last step necessary to have the deal with Red Owl go through.

We determine that there was ample evidence to sustain the answers of the jury to the questions of the verdict with respect to the promissory representations made by Red Owl, Hoffman’s reliance thereon in the exercise of ordinary care, and his fulfilment of the conditions required of him by the terms of the negotiations had with Red Owl.

We conclude that injustice would result here if plaintiffs were not granted some relief because of the failure of defendants to keep their promises which induced plaintiffs to act to their detriment.

Where damages are awarded in promissory estoppel instead of specifically enforcing the promisor’s promise, they should be only such as in the opinion of the

court are necessary to prevent injustice. Mechanical or rule-of-thumb approaches to the damage problem should be avoided.

[The court then examines the propriety of various elements of Plaintiff's damages.]

By the Court.—Order affirmed.

Review Question 3. In *Ricketts*, Katie could fairly assume that her grandfather would be acting with her best interests at heart and that he could reasonably be relied upon to keep his promise. Small-businessman Hoffman, in contrast, was dealing with another business in an arms-length negotiation where a contract was never actually finalized. Was it really reasonable for Hoffman to rely on a promises made by Red Owl during the parties' negotiations? Why or why not?

Review Question 4. Suppose you are the transactional lawyer asked by Red Owl to figure out a way to make sure that this thing never happens again—that when Red Owl is negotiating a franchise agreement, it will not be liable until the final agreement is signed. What would you recommend to Red Owl, especially given that the parties in *Hoffman* never actually entered into a contract? To what extent can Red Owl actually rely on the proposition that the “offeror is master of the offer”?

MAYER v. KING COLA MID-AMERICA, INC.

Court of Appeals of Missouri, Eastern District
660 S.W.2d 746 (Mo. Ct. App. 1983)

STEPHAN, J.

Plaintiff Theodore Mayer is experienced in the soft drink business, and has worked in that business since 1956. Plaintiff was employed by Pepsi Cola International for many years, and worked abroad setting up and managing soda franchise operations. In 1978, he returned to the United States and eventually was employed by Double Cola as Vice President of Marketing. After Mr. Mayer resigned from Double Cola, in January 1980, he was contacted by Linda Leary, then secretary and later president of defendant King Cola Mid-America, Inc. She inquired as to his interest in a position as general manager of a new soda franchise in St. Louis. On February 2, 1980, plaintiff met with Ms. Leary. A three-year employment contract

was discussed with compensation to be set at \$40,000 the first year and \$45,000, and \$50,000 in each succeeding year, plus an additional commission based on sales. In addition, defendant promised to pay plaintiff's moving expenses up to \$5,000. Plaintiff recovered judgment for these expenses as prayed for in his Count II, and they are not an issue here. Plaintiff agreed to work for defendant, and moved from his home in Chattanooga, Tennessee to St. Louis. He began work for defendant in February 1980; and in accordance with the negotiations, he awaited a written contract. No written agreement, however, was executed. The relationship between plaintiff and defendant deteriorated in the months that followed. In late April, or early May, Ms. Leary informed plaintiff that he was not going to be given a contract. A few weeks later, plaintiff was asked to resign; when he refused, he was terminated.

[Because the three-year contract was never executed, it was unenforceable under Missouri's Statute of Frauds (a topic covered elsewhere in these materials) Since Mayer was merely an employee at will, his breach of contract claim failed.]

Plaintiff's alternative argument is that the doctrine of promissory estoppel excuses compliance with the requirements of the Statute of Frauds.

We acknowledge that the doctrine of promissory estoppel has been resorted to in Missouri in extreme cases to avoid unjust results. To some extent the concept has been intermixed with the doctrine of equitable estoppel or estoppel in pais. In one such case, *In re Jamison's Estate*, 202 S.W.2d 879, 886 (Mo. 1947), our Supreme Court quoted with favor from Section 90 of the Restatement of the Law of Contracts

A promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.

In two subsequent cases, Missouri Courts have used the doctrine of promissory estoppel to permit recovery by former employees who had retired in reliance upon promises that they would be paid lifetime pensions and the employers later stopped making payments. *Feinberg v. Pfeiffer Company*, 322 S.W.2d 163 (Mo. Ct. App. 1959); *Katz v. Danny Dare, Inc.*, 610 S.W.2d 121 (Mo. Ct. App. 1980). In each of those cases, plaintiff's reliance upon the promise to his detriment was held to supply the otherwise missing element of consideration and thus to establish a contractual obligation of the defendant to honor the promise.

We do not find [*Feinberg* and *Katz*] persuasive on the issue before us. Plaintiff did not have a "promise" in the contractual sense. In view of the evidence concerning many unsettled matters to be embodied in the written contract, particularly the potentially very substantial item of plaintiff's commission, the relationship here would be more properly characterized as an "expectation of a promise" rather than an accomplished fact. If the final form of the written contract tendered to plaintiff had not been satisfactory to him in such matters, for example, as the commission or

covenant not to compete, he could have abandoned the relationship with impunity. Absent mutuality, there can be no contract to enforce at law or equity. Moreover, even if it could be said that a promise existed here, plaintiff's action in reliance thereon constituted no detriment to him. At the time plaintiff was contacted by Ms. Leary, he was unemployed; he did not forego continued employment. Although he moved from Chattanooga, Tennessee to St. Louis in order to commence his duties, he recovered judgment for his moving expenses in the court below. Finally, he was compensated at the "contractual" rate of \$40,000 per year by the defendant through the time of his termination. Thus, adherence to the mandate of the Statute of Frauds would work no injustice. In *Katz*, it is said, "There are three elements to be satisfied to invoke the Doctrine of Promissory Estoppel. These are: (1) a promise; (2) a detrimental reliance on such promise; and (3) injustice can be avoided only by enforcement of the promise." Plaintiff's case is wanting in all three elements and is barred by the Statute of Frauds.

In *Morsinkhoff v. DeLuxe Laundry & Dry Cleaning Co.*, 344 S.W.2d 639 (Mo. App. 1961), plaintiff entered into an oral agreement whereby plaintiff would accept a managerial position in defendant's business at \$10,000 per year. Plaintiff was employed at the time; and, because he wanted to give his current employer one month's notice of his resignation and take a week's vacation before commencing his new job, it was agreed that he would start work thirty-seven days later. The evidence was in conflict as to whether the term of the contract was to be one year or for an indefinite period. Thereafter, plaintiff gave his notice, resigned and offered to start his new employment with defendant. Defendant, however, refused to allow him to start work, and plaintiff sought different employment. Plaintiff prevailed in the trial court, recovering damages for the time he was out of work, bonus lost by reason of his resignation, and expenses incurred in obtaining new employment.

In reversing, the court held that, if the contract was for an indefinite period, it was terminable at will and the employer incurred no liability for not allowing the employee to start.

The judgment is affirmed.

Review Question 5. The *Mayer* court notes that there were many details still to be settled about the contract, and suggests that if Mayer had disliked the final proffered contract, he could have "abandoned the relationship with impunity." Wasn't that also true of the plaintiff in *Hoffman v. Red Owl Stores*? Are the facts of these two cases distinguishable or are the two courts acting inconsistently in their application of promissory estoppel doctrine?

CONRAD v. FIELDS

Court of Appeals of Minnesota
2007 Minn. App. Unpub. LEXIS 744

Appellant Walter R. Fields and respondent Marjorie Conrad met and became friends when they were neighbors in an apartment complex in the early 1990's. Appellant started his own business and became a financially successful businessman. Appellant built a \$1.2 million house in the Kenwood neighborhood in Minneapolis and leased a Bentley automobile for more than \$50,000 a year. Appellant is a philanthropic individual who has sometimes paid education costs for others.

In the fall of 2000, appellant suggested that respondent attend law school, and he offered to pay for her education. Respondent, who had recently paid off an \$11,000 medical bill and still owed about \$5,000 for undergraduate student loans, did not feel capable of paying for law school on her own. Appellant promised that he would pay tuition and other expenses associated with law school as they became due. Appellant quit her job at Qwest, where she had been earning \$45,000 per year, to attend law school. Appellant admitted at trial that before respondent enrolled in law school, he agreed to pay her tuition.

Respondent testified that she enrolled in law school in the summer of 2001 as a result of appellant's "inducement and assurance to pay for [her] education." Appellant made two tuition payments, each in the amount of \$1,949.75, in August and October 2001, but he stopped payment on the check for the second payment. At some point, appellant told respondent that his assets had been frozen due to an Internal Revenue Service audit and that payment of her education expenses would be delayed until he got the matter straightened out. In May 2004, appellant and respondent exchanged e-mail messages about respondent's difficulties in managing the debts that she had incurred for law school. In response to one of respondent's messages, appellant wrote, "to be clear and in writing, when you graduate law school and pas[s] your bar exam, I will pay your tuition." Later, appellant told respondent that he would not pay her expenses, and he threatened to get a restraining order against her if she continued attempting to communicate with him.

Respondent brought suit against appellant, alleging that in reliance on appellant's promise to pay her education expenses, she gave up the opportunity to earn income through full-time employment and enrolled in law school. The case was tried to the court, which awarded respondent damages in the amount of \$87,314.63 under the doctrine of promissory estoppel. The district court denied appellant's motion for a new trial or amended findings. This appeal followed.

Appellant argues that respondent did not plead or prove the elements of promissory estoppel. Minnesota is a notice-pleading state that does not require

absolute specificity in pleading and, instead, requires only information sufficient to fairly notify the opposing party of the claim against it.

Paragraph 12 of respondent's complaint states, "That as a direct and approximate result of the negligent conduct and breach of contract conduct of [appellant], [respondent] has been damaged" But the complaint also states:

4. That in 2000, based on the assurance and inducement of [appellant] to pay for [respondent's] legal education, [respondent] made the decision to enroll in law school at Hamline University School of Law (Hamline) in St. Paul, Minnesota which she did in 2001.

5. That but for the inducement and assurance of [appellant] to pay for [respondent's] legal education, [respondent] would not have enrolled in law school. [Appellant] was aware of this fact.

Paragraphs four and five of the complaint are sufficient to put appellant on notice of the promissory-estoppel claim.³

At a pretrial deposition, respondent testified that negligence and breach of contract were the only two causes of action that she was pleading. Because promissory estoppel is described as a contract implied at law, respondent's deposition testimony can be interpreted to include a promissory-estoppel claim.

In its legal analysis, the district court stated:

The Court finds credible [respondent's] testimony that [appellant] encouraged her to go to law school, knowing that she would not be able to pay for it on her own. He knew that she was short on money, having helped her pay for food and other necessities. He knew that she was working at Qwest and would need to quit her job to go to law school. He offered to pay for the cost of her going to law school, knowing that she had debts from her undergraduate tuition. He made a payment on her law school tuition after she enrolled. [Respondent] knew that [appellant] was a wealthy philanthropist, and that he had offered to pay for the education of strangers he had met in chance encounters. She knew that he had the wealth to pay for her law school education. She knew that [] he was established in society, older than she, not married, without children, an owner of a successful company, an owner of an expensive home, and a lessor of an expensive car. Moreover, [appellant] was a friend who had performed many kindnesses for her already, and she trusted him. [Appellant's] promise in fact induced [respondent] to quit

³ [Practice tip: As a lawyer, you never want to have to make the court decide whether you said just enough to put the other party "on notice" of the claim. Be clear. Not all judges will be this forgiving of a vaguely stated claim.—Eds.]

her job at Qwest and enroll in law school, which she had not otherwise planned to do. . . .

. . . [T]he circumstances support a finding that it would be unjust not to enforce the promise. Upon reliance on [appellant's] promise, [respondent] quit her job. She attended law school despite a serious health condition that might otherwise have deterred her from going.

These findings are sufficient to show that respondent proved the elements of promissory estoppel.

Appellant argues that because he advised respondent shortly after she enrolled in law school that he would not be paying her law-school expenses as they came due, respondent could not have reasonably relied on his promise to pay her expenses to her detriment after he repudiated the promise. Appellant contends that the only injustice that resulted from his promise involved the original \$5,000 in expenses that respondent incurred to enter law school. But appellant's statement that he would not pay the expenses as they came due did not make respondent's reliance unreasonable because appellant also told respondent that his financial problems were temporary and that he would pay her tuition when she graduated and passed the bar exam. This statement made it reasonable for respondent to continue to rely on appellant's promise that he would pay her expenses.

Appellant argues that because respondent received a valuable law degree, she did not suffer any real detriment by relying on his promise. But receiving a law degree was the expected and intended consequence of appellant's promise, and the essence of appellant's promise was that respondent would receive the law degree without the debt associated with attending law school. Although respondent benefitted from attending law school, the debt that she incurred in reliance on appellant's promise is a detriment to her.

Review Question 6. The principal purpose of “reliance” damages (a topic addressed in this book at much greater length in Chapter VIII) is to put the relying promisee back in her pre-contractual position by restoring to her what she has lost. The court says that Fields promised Conrad “a law degree without the debt.” But what she was *promised* and what she has *lost* in reliance on that promise are two different things. Doesn't getting the money she spent *and* getting a law degree actually put her in a *better* position than she was before the promise was made? To what extent, in the language of section 90 of the Second Restatement, can injustice actually be avoided only by enforcement of the promise?

Problems

Problem 9.1

Drennan is a construction contractor who is bidding on a new project. Part of the project involves paving. A subcontractor, Star, submits a bid to do the paving part of the project for \$500,000. Drennan does not require that Star certify that its bid is irrevocable, nor does Drennan pay Star for an option. Drennan uses Star's bid in putting together its own \$10 million primary contract bid on the project. Drennan subsequently is awarded the prime contract on the project. Before it can contact Star, however, Star calls to say that it cannot do the job at the price it bid. Drennan demands that it perform; Star refuses. Drennan immediately seeks other contractors, but cannot find anyone who will do the job for less than \$700,000. Drennan hires the new contractor, pays \$700,000, and then sues Star, arguing that Star is liable for \$200,000 in damages because Drennan relied on Star's original bid. What are the legal arguments for each party in this situation?

Problem 9.2

Antillico is a poor woman with twelve children, whose husband has just died. Her brother-in-law, Isaac, writes to her:

Dear Antillico,

Much to my mortification, I heard, that brother Henry was dead. I know that your situation is one of grief, and difficulty. You had a bad chance before, but a great deal worse now. If you will come down and see me, I will let you have a place to raise your family, and I have more open land than I can tend; and on the account of your situation, and that of your family, I feel like I want you and the children to do well.

Antillico, at some expense to herself, packs up her kids in her 1987 Ford Econoline van and drives down. Isaac greets her joyfully and lets her move into an empty house on his property. Six years later, relations between Isaac and Antillico have become strained and Isaac demands that she move out. Antillico sues, claiming that she relied on Isaac's promise in moving, and arguing that she should be entitled to damages for her loss. What result under the cases and materials in this unit? How does that answer compare with the result you would get applying the consideration doctrine that you studied before this unit?

Problem 9.3

Seth Wyman's estranged son Levi is a sailor who on his return to America is struck ill and dies. During Levi's last illness, he is tended tenderly by Daniel Mills, who takes much of his own time to care for the young man. Upon Levi's death, Mills writes to Seth, explaining what happened and describing what he did. Seth writes back, thanking Mills and promising to send him \$10,000 to reimburse him for the time and expenses he incurred taking care of Levi. After getting the letter, Mills—who needs a car—goes out and buys on credit a pre-owned Volvo S360 sedan for \$10,000. Seth subsequently refuses to pay the money to Mills. Mills sues, claiming he relied on the promise to buy the car. What are the legal arguments for each party in this situation?



AMERICAN CONTRACT LAW FOR A GLOBAL AGE

Chapter IV: Alternative Regimes

Unit 10: Uniform Commercial Code – Scope and Formation

Unit 11: Uniform Commercial Code – Merchants and Terms

Unit 12: United Nations Convention on Contracts for the International Sale of Goods

An Introduction to

ALTERNATIVE REGIMES OF CONTRACT LAW

Common Law is the Beginning of American Contract Law, not the End. This course focuses on the common law of contracts because that law is a fundamental foundation for many advanced substantive areas of law. The common law is also the default law of contracts that will apply where it has not been displaced by other law. Nearly every aspect of contract law has, however, been augmented to a greater or lesser degree by statutes relating to particular kinds of contracts. Where such statutes apply, the common law is changed. Real estate contracts, insurance contracts, employment contracts, professional services contracts, construction contracts, and consumer contracts are all rooted in the common law of contracts, but all also have distinctive statutory schemes. After the first year of law school, you will have the opportunity to study some of these specialized areas

Specialized regimes of contract law can vary greatly from state to state, but two regimes are both important and ubiquitous enough that they are universally recognized as an important part of American contract law: (1) the Uniform Commercial Code—or as most every lawyer also knows it, the “UCC.”¹ and (2) the United Nations Convention on Contracts for the International Sale of Goods—most frequently referred to as the “CISG.” The CISG is an international treaty to which the United States is a party. Having been ratified by the United States Senate, the CISG is binding federal law under the Constitution, and you can read its provisions much as you read a statute. In a global economy, both of these legal structures are extremely important, impacting trade and commerce locally, nationally, and internationally. The three units in this section explore the ways in which the UCC and the CISG vary the common law rules of contract.

¹ [The acronym is pronounced “YOU-SEE-SEE,” and not “UCK.” Many law students over the years have, however, decided the latter is more descriptive of their personal interactions with the code. We hope you won’t necessarily fall into that category. – Eds.]

Unit 10: Uniform Commercial Code – Scope and Formation

ALTERNATIVE REGIMES

Part One

FOCUS OF THIS UNIT

Welcome to the Uniform Commercial Code. The Uniform Commercial Code has major substantive divisions dealing with different topics, each one of which is known as an “article.” Every article is then divided into “sections,” which are like code sections you have seen in other contexts. Article 1 (“General Provisions”) contains principles and definitions that apply to the rest of the code, so it can come up in any study of the UCC, including in a basic course on contracts. Other UCC articles frequently arise in upper level law school courses, perhaps most prominently Article 3 (“Negotiable Instruments”), Article 4 (“Bank Deposits and Collections”), and Article 9 (“Secured Transactions”). The UCC as a whole was largely developed in the 1940s and 1950s as a joint effort by the American Law Institute (whom you may already recognize as the drafters of all the Restatements) and the National Conference of Commissioners on Uniform State Laws (now better known as the “Uniform Law Commission”), both being groups comprised of law professors and practicing lawyers. Most state enactments of the UCC first occurred in the mid-to-late 1960s.

Welcome to UCC Article 2 on Sales of Goods. The part of the code that we (and by “we,” of course, we actually mean “you”) will study most for this course is Article 2, which governs sales of “goods.” Article 2 has been adopted in every American jurisdiction except Louisiana,¹ and it was designed with the goal that people and companies selling products nationally should not have to worry about the specific contract law of every state. Like many pieces of legislation, Article 2 reflects a number of political compromises, balancing the interests of big businesses, small businesses, and consumers, and of both buyers and sellers. It was also largely written

¹ [Louisiana has a French-based civil code system known as “Obligations” in lieu of the British-originated common law of contracts. Louisiana has adopted some parts of the Uniform Commercial Code, but not UCC Article 2, which is the principal subject of this unit. – Eds.]

by law professors, who are (you may have already recognized) are not *always* noted for their clarity in communication. As a result, it is not always a model of clarity or consistency. Some provisions have proved extremely successful in practice, others less so. In particular, many have criticized the Code as not particularly responsive to consumer problems, and as a result nearly every state has specific consumer-protection laws that supplement both the Code and the common law of contracts.

In many areas, the rules of Article 2 are similar to those of the common law, but in a number of important contract doctrines the rules are significantly different. These differing rules, as you can see from the cases below, can cause different results in cases than if we applied the common law.

One of the most important takeaways from this unit should be an understanding of *which contracts* are governed by Article 2. The cases below also address offer, acceptance, and consideration in the context of contracts for the sale of goods. In subsequent units, we will occasionally see how differences between the common law and the UCC play out in other areas.

The UCC is State Law, not Federal Law. Some law students tragically assume that because the Uniform Commercial Code is the law of nearly all states, it is federal law. That assumption is profoundly wrong. The Uniform Commercial Code is *state* law that must be enacted by *state* legislatures to be effective. State legislatures occasionally enact UCC sections that vary in some way from the “official” UCC text we will consider here. The state supreme court in each state has the authority to make the definitive interpretation of an enacted UCC section *in that state*. Thus, if the Texas Supreme Court interprets a code provision one way, but the Missouri Supreme Court later interprets the identical provision in a way that conflicts with the Texas case, both interpretations are binding as the law of each court’s home state. If you ask us, we think a more accurate name for the Uniform Commercial Code would be the “Mostly-but-not-entirely ‘uniform’ Commercial Code.” But nobody asked us.

Much Common Law Coexists with the UCC. Although we will tend to focus on areas where UCC Article 2 changes the result under the common law, you should understand that the UCC explicitly endorses the use of the common law (and other law) in areas that it does not address. Take a moment to read UCC § 1-103(b) for the definitive statement of this principle. In situations that it does not address, UCC Article 2 assumes the existence of—and applicability of—the common law of contracts.

What Is an “Official Comment,” Anyway? In many UCC cases, courts will refer to or quote from the official comments to the UCC, which are paragraphs—sometimes numbered—that follow each section of the code. You can think of these comments as a sort of legislative history. The drafters of the code wanted to explain what the origin or intent was for specific code sections, and they put those explanations into a comment rather than in the text of the statute. Like other legislative history, the official comments are not “law” and courts are not bound to

follow them. While the official comments are merely persuasive authority, you should be aware that they are *highly* persuasive authority that courts will frequently defer to absent a good reason to do otherwise.

Some people believe—not without reason—that the comments to the UCC are occasionally used to further policies or goals that did not have enough support to make it into the statutory text. As a practicing attorney, you should be prepared to use the official comments when they support your position, but you should also be prepared to argue against them when they do not. The one thing an attorney should *not* do with the official comments is ignore them.

Official Code Numbering vs. State Code Numbering. Here is one more thing you should know about the UCC as it relates to legal research: Each jurisdiction codifies its provisions differently because each state uses its own numbering system for state statutes. Fortunately, most states incorporate the UCC numbering system into their own in some recognizable way. For example, UCC § 2-105 becomes Indiana Code § 26-1-2-105, Tennessee Code § 47-2-105, and 13 Pennsylvania Statutes § 2105. Beware that some states have murkier numbering, however. Practice tip: If you find yourself litigating an Article 2 case, *be sure to find the version in your state’s code.*

In this unit and elsewhere, we have edited citations to the Uniform Commercial Code in the cases so that they will refer you to the “Official” version of the UCC that you can find in many law school statutory supplements (or in online databases, such as the free-to-access materials of the Legal Information Institute: <https://www.law.cornell.edu/ucc>). You will generally find it helpful to see the statute separately, even where courts provide you with a lengthy quotation. Doing so will enable you to see the larger context in which particular sections of the code operate.

Cases and Materials

Statutory Note. In connection with the *Tousley-Bixler Construction* case that follows, read UCC §§ 2-102, 2-105 and 2-107, all of which relate to when UCC Article 2 does or does not apply.

TOUSLEY-BIXLER CONSTRUCTION CO.
v. COLGATE ENTERPRISES, INC.

Court of Appeals of Indiana
429 N.E.2d 979 (Ind. Ct. App. 1982)

BUCHANAN, J.

Tousley-Bixler, as contractor of a sanitation project for the City of Indianapolis, needed clay soil to construct a levee. Colgate's property was located near the construction site, so Fred Lind of Tousley-Bixler contacted Colgate about the possibility of purchasing clay. Subsequent tests on Colgate's property revealed that before reaching the approximately four to eight feet of clay beneath the surface, Tousley-Bixler would have to remove about four feet of top soil.

On April 2, 1976, Lind delivered a purchase order to Colgate for 50,000 cubic feet of clay. Discussions then ensued between Tousley-Bixler and Colgate regarding disposal of brush. The purchase order as signed and returned contained an additional statement typed in by Colgate that any material used in 1976 was to be paid for on or before January 10, 1977.

On receipt of the purchase order with this additional provision typed in, Tousley-Bixler mailed an addendum to cancel the order because of failure to reach agreement on brush removal. Colgate responded by letter in June 1976 that it did not realize there was a problem as to brush removal and for Tousley-Bixler to proceed as originally agreed. Nevertheless, Tousley-Bixler failed to remove any clay.

In an action brought by Colgate for breach of the agreement, the trial court instructed the jury under both the common law and Indiana's version of the Uniform Commercial Code (UCC). The jury found for Colgate, and Tousley-Bixler appeals.

Did the trial court commit reversible error in instructing the jury under the provisions of the UCC?

According to Tousley-Bixler, the sale of clay soil is not a sale of goods within the meaning of Ind. Code subsection 2-107(1) or 2-107(2), because the clay soil is to be removed by the buyer, not the seller, and because such soil is part of the realty.

Colgate counters that the UCC is a codification of the common law, so no error or prejudice could result from the giving of instructions under both the common law and the UCC. In any event, the UCC is applicable.

Buried somewhere in that mountain of words known as the UCC is the answer as to whether clay soil lying four feet below the surface is "goods."

Tousley-Bixler is particularly disturbed because the trial court gave an instruction under a provision of 2-206 (relating to contract formation) which in effect

treated the sale of clay as a transaction “in goods.” “Goods” are defined in UCC § 2-105 as

all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (Article 8) and things in action. “Goods” also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty (section 2-107).

The term “movable” is somewhat elusive in that virtually anything is movable, even Blackacre, “in the sense that much of the dirt, gravel, water, and minerals that comprise the ‘things’ called Blackacre can be transported to another location.” ROBERT J. NORDSTROM, HANDBOOK OF THE LAW OF SALES § 22, at 45 (1970). However, movable is modified by “at the time of identification,” and there is further reference to growing crops which can be severed. Considered as a whole, “the words of section 2-105 lose much of their obscurity. The drafters were concerned with items of tangible property which were portable at the time they were set aside for their transfer, items which normally flow in commerce.” *Id.* at 46.²

Indicative of the variety of items which may be classified as goods within the meaning of section 2-105 are hoghouses, electricity, mobile homes, growing crops, tomato seeds, and modular homes. *See Thompson Farms, Inc. v. Corno Feed Products*, 366 N.E.2d 3 (Ind. Ct. App. 1977); *Helvey v. Wabash County REMC*, 176, 278 N.E.2d 608 (Ind. Ct. App. 1972); *Jones v. Abriani*, 350 N.E.2d 635 (Ind. Ct. App. 1976); *Sebasto v. Perschke*, 404 N.E.2d 1200 (Ind. Ct. App. 1980); *Stumler v. Ferry-Morse Seed Co.*, 644 F.2d 667 (7th Cir. 1981); *Stephenson v. Frazier*, 399 N.E.2d 794 (Ind. Ct. App. 1980). None of these seem similar to the sale of several feet of clay soil lying four feet beneath the surface of the earth.

There is another section which should be read with § 2-105, to-wit, § 2-107. Section 2-107 provides in part:

- (1) A contract for the sale of timber, minerals or the like or a structure or its materials to be removed from realty is a contract for the sale of goods within this Article if they are to be severed by the seller but until severance a purported present sale thereof which is not effective as a transfer of an interest in land is effective only as a contract to sell.
- (2) A contract for the sale apart from the land of growing crops or other things attached to realty and capable of severance without material harm thereto but not described in subsection (1) is a contract for the sale

² [By the Court:] The comment to 2-105, explains that growing crops are goods because “they are frequently intended for sale.”

of goods within this Article whether the subject matter is to be severed by the buyer or by the seller even though it forms part of the realty at the time of contracting, and the parties can by identification effect a present sale before severance.

Comment 1 to § 2-107(1) emphasizes that 2-107(1) “applies only if the timber, minerals or structures ‘are to be severed by the seller.’ If the buyer is to sever, such transactions are considered contracts affecting land.” It is to be remembered that buyer Tousley-Bixler was to remove the clay from seller Colgate’s property.

Thus, the UCC considers the sale of some items affixed to real estate as a sale of goods if they are to be severed by the seller, *i.e.*, “timber, minerals or the like or a structure or its materials.” If the seller is to sever the items from the real estate, they are treated as goods because they would more likely be intended for sale after severance. The protections reserved for the sale of real estate would not be necessary.

On the other hand, if the buyer is to sever the items, there is a good reason for not applying the UCC to the transaction: “A lease of land ought not be converted into a contract for the sale of goods even though the lessee in possession is given the privilege of removing a part of the realty—such as its gravel, coal or oil. Lawyers have too long thought of such an arrangement as a lease with all the intended duties of recording determined under real estate statutes.” R. NORDSTROM, *supra*, at 48. Williston makes much the same point in his treatise on sales:

Common law and sales law have not treated goods and realty to be one and the same. Real estate has been the subject matter of its own well developed law, including among other things, recording statutes, title statutes and other related real property law all dependent upon the locus of the land. Sales law, however, hinges on commercial fluidity which has in turn necessitated a modification of the law to promote uniformity and to facilitate the expanding and transient market for goods.

ALPHONSE M. SQUILLANTI & JOHN R. FONSECA, 1 WILLISTON ON SALES § 6-6, at 170 (4th ed. 1973).

The distinction between personalty and realty is important. In view of the express language of § 2-107, we fail to see how Colgate’s intended sale of dirt was a sale of goods. It is undisputed that seller Colgate was not to sever the goods for buyer Tousley-Bixler. So we conclude that the sale of several feet of clay soil, which could only be reached by removing several feet of top soil, was a sale of “mineral or the like.” *See* § 2-107(1).

For over 100 years Indiana law has treated such sales as transactions affecting realty. *See Owens v. Lewis*, 46 Ind. 488 (1874) (growing trees); *Armstrong v. Lawson*, 73 Ind. 498 (1881) (growing trees); *Callihan v. Bander*, 73 N.E.2d 360 (Ind. Ct. App.

1947) (oil and gas lease); *Creasey v. Pyramid Coal Corp.*, 61 N.E.2d 477 (Ind. Ct. App. 1945) (conveyance of coal, clay, and minerals).

Colgate cites us to no precedent leading to a contrary conclusion, whereas *Tousley-Bixler* directs us to *DeLuca v. C. W. Blakeslee & Sons, Inc.*, 391 A.2d 170 (Conn. 1978). In *DeLuca* the Supreme Court of Connecticut pointed out that § 2-107(1) “made a significant distinction between instances where the subject of the profit *a prendre* was to be severed from the realty by the seller rather than the buyer.” Because the agreement in that case “provided that the buyer of fill dirt should remove it from the plaintiff’s land . . . , the [trial] court properly concluded to be enforceable it was necessary that the alleged agreement conform to the Statute of Frauds affecting the transfer of an interest in land.”

[We conclude] that the sale was not a sale of goods within the meaning of the UCC. So the trial court should not have given instructions based on the UCC which conflicted with the common law.

Although it was error for the trial court to give UCC instructions conflicting with the common law and which were not supported by the evidence, to obtain reversal *Tousley-Bixler* has the burden of proving prejudicial error. Prejudice is not presumed when erroneous instructions are given over objection if the jury has unquestionably reached the right result, but we cannot say that the jury unquestionably reached the right result in finding for Colgate.

The jury was given conflicting instructions regarding contract formation. [The court notes that under the common law Colgate’s signing of the purchase order with a new term typed in would be a counter-offer, and therefore no contract would be formed. Under the UCC, it would be an “acceptance” with “additional or different” terms, which would mean that a contract was formed. Thus the issue of the contract’s existence depended on which law applied.]

The evidence could support a jury finding under either instruction with differing results. There is no way of knowing if the jury reached the right result under these circumstances. So *Tousley-Bixler* was prejudiced by the giving of erroneous instructions based on the UCC and is entitled to a new trial with proper instructions.

Reversed and remanded for a new trial.

Review Question 1. If Colgate had previously dug up and bagged the clay for sale itself, the clay would be “goods” governed by the UCC, but where *Tousley-Bixler* is responsible for strip-mining it out, the clay is “mineral” governed by the common law of contracts. Does that distinction really make sense? As you read *Tousley-Bixler Construction*, what possible policy reasons can you discern for treating sales of goods

differently from other contracts? For that matter, why would we sometimes treat real estate differently from other contracts?

Review Question 2. Notice that the determination of whether the agreement in *Tousley-Bixler Construction* was for a sale of goods or not affected something fundamental: the certainty (or not) of whether a contract between the parties even existed. The contract formation rules of UCC differ substantially from the common law. We have already seen how the doctrines of consideration and promissory estoppel can cause a great deal of uncertainty for the legal status of parties to an agreement. At this point in the course, how much value do you think the law of contracts should place on *certainty* as opposed to *fairness* when those two values come into conflict, as they inevitably do?

Statutory Note. In connection with the *Computer Network* case that follows, read UCC §§ 1–201(b)(3) (definition of “agreement”), 1–201(b)(12) (definition of “contract”) and 2-204 (entitled “Formation in General”). As you read the case, keep a running list for yourself on differences between the UCC and the common law on contracts on how and when contracts are formed. You will find that a grasp of these differences will be quite useful for the remainder of the course.

***COMPUTER NETWORK, LTD. v.
PURCELL TIRE & RUBBER COMPANY***

Missouri Court of Appeals
747 S.W.2d 669 (Mo. App. 1988)

SIMEONE, Senior Judge.

[Purcell operated a small chain of tire stores. Its president was Robert Purcell and its comptroller was Harry Chapman. Computer Network was a computer broker who purchased computer hardware and software from IBM and other vendors and resold it to customers. Curtis Brown was the president of Computer Network. The parties had discussions about putting computers into Purcell’s office and stores, which was a new idea in 1983. Brown worked with Purcell and Chapman on a computer configuration for the company, and then negotiated with Chapman on price.]

After these discussions were held and on February 23, 1984, Brown prepared a letter, took it to Chapman at Purcell and Chapman signed it. Brown gave him a copy. The letter read as follows:

February 23, 1984

Mr. Harry Chapman
Purcell Tire Company
P.O. Box 100
Potosi, Missouri 63664

Dear Harry,

Please let this letter serve as written confirmation of our previous conversations regarding the purchase by Purcell Tire of twenty-one (21) IBM PCs over the next twelve (12) months.

The configuration of the systems you are to purchase are as follows:

IBM PC 256K—One Diskette Drive	\$2,454.00
Monochrome Display & Printer Adapter	335.00
Monochrome Display	345.00
10 MG Disk Drive	1,450.00
Hayes Smart Modem 1200B w/SmartCom II	599.00
Okidata Printer 92P w/Cable	649.00
<u>IBM D.O.S. 2.1</u>	<u>65.00</u>
	\$5,897.00
Less 10% Discount:	(589.70)
	\$5,307.30

As per our understanding, we have placed two machines on order for immediate delivery.

If this is in accordance with your understanding, please sign the enclosed copy of this letter and return. If this is not in accordance with your understanding, please let me know as soon as possible.

Sincerely,

/s/ Curtis L. Brown

Curtis L. Brown,
President

CLB:skj

Signature */s/ Harry Chapman*

Date 2/24/84

In March 1984, two units were delivered to Purcell and paid for promptly. Over the next few months, seven other units were delivered and paid for. The last of the

nine units was delivered and paid for in December, 1984. No further deliveries were made and no further units were paid for.

Sometime after February 1985, after the expiration of the “agreement,” Brown telephoned Chapman concerning the delivery of the remaining twelve computers and “he said that we had no such agreement, so we sent him a copy of the agreement [letter], showing him.”

On September 27, 1985, Computer Network filed its petition for damages for breach of contract. It alleged that the parties “entered into a written contract regarding the sale of twenty-one (21) IBM Personal Computers” and that Purcell “breached the Agreement by not purchasing the additional twelve (12) units.” Computer prayed for \$25,515.60 in damages.

Purcell answered denying that it had entered into a contract to purchase the twenty-one computers, and asserted that “there never was a contract, as indicated by the letter,” but “there had only been conversations regarding the possible transaction.”

On January 30, 1987, the cause was heard by the trial court on a change of venue. At the hearing, Brown testified as to the facts stated above and testified that the letter was the “final and complete expression of [the] agreement.” He testified that Purcell did not request the additional twelve units, that Computer Network was making a profit of \$2,008.30 per unit and that it lost profits of \$24,099.60.

[At trial, the parties testified about their conversations and understandings, but they did not agree. Basically, Purcell’s witnesses stated that Purcell had never agreed to buy twenty-one computers.]

Following the hearing, and on March 30, 1987, the trial court found the issues in favor of Computer Network and entered judgment for \$24,099.60 plus interest.

Purcell appealed. On appeal, Purcell contends that [the parties did not enter into a legally binding “contract”].

A resolution of the issues requires adherence to the time-tested principles of common law and the various provisions of Missouri’s Uniform Commercial Code relating to the sale of goods. UCC §§2-101 to 2-725 (1986). We deal here with the sale of “goods” as defined in § 2–105(1). We also deal with various principles of the common law of contracts which have not been displaced by the Code. § 1-103.

Under the Uniform Commercial Code, “a contract for the sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.” UCC § 2-204(1). The Code defines “contract” as the “total legal obligation which results from the parties’ agreement as affected by the code and any other applicable rules of law.” [§ 1-201(b)(12)]. An “agreement” “means the bargain of the parties in fact as found in their language or by implication from the circumstances including course of dealing or usage of trade

or course of performance....” [§ 1–201(b)(3)]. The provisions of the Code are to be liberally construed. Article Two expands the traditional concept of a contract and imposes new and wider ranges of obligation. J. WHITE AND R. SUMMERS, UNIFORM COMMERCIAL CODE, § 1–1 at 23–24 (1980). In keeping with this liberal trend, the Official Comment to the Code, Section 2–204, states that if the parties intend to enter into a binding agreement and an appropriate remedy may be fashioned, a contract for sale does not fail despite missing terms, if there is any reasonably certain basis for granting a remedy. The Code, however, will not imply an agreement if the parties did not reach or intend one. Section 2–204 requires an agreement between the negotiating parties. But the Code focuses upon “mutuality of assent as manifested by the conduct of the parties” in place of the 19th century’s subjective test of intent.

While Section 2–204 provides that a contract for the sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract, this section continues the common-law principle that the intent of the parties to make a contract must be manifested. The basic philosophy of this article is simple.

Practical business people cannot be expected to govern their actions with reference to nice legal formalisms. Thus, when there is basic agreement, . . . failure to articulate that agreement in the precise language of a lawyer with every difficulty and contingency considered and resolved, will not prevent formation of a contract.”

Kleinschmidt Div. of SCM Corp. v. Futuronics Corp., 41 N.Y.2d 972, 395 N.Y.S.2d 151, 363 N.E.2d 701 (1977) (quoted in 2 R. ANDERSON, UNIFORM COMMERCIAL CODE, § 2–204:4 at 201 (1982)).

The core issue here, under the evidence, is whether the parties intended a legally binding contract to arise from the February 23, letter. If the parties intended no binding agreement or contract, the rules of construction and interpretation will not establish one. If no intent is found, the inquiry is put to an end. If the expressions in the agreement are clear, the court determines the intent from a reading of the writing. If the intent is not clearly expressed, then surrounding circumstances may be considered—the subsequent actions of the parties and the practical construction of the contract. But the question whether there is an “intent to contract” is a question of fact to be determined by the trier of fact. Under UCC § 2-204(1), in order to determine whether there is an enforceable contract, the court must find that the circumstances, including conduct, are sufficient to show agreement. The formation of a contract does not require that all terms be settled. One or more of the terms may be left open and the agreement will not fail for indefiniteness; but the parties must intend to make a contract. If the parties act in a way which recognizes the existence of a contract, one may exist even though the writing does not otherwise establish a contract. “Sellers usually do not ship and buyers do not receive goods unless they

think they have struck a deal.” *Quaker State Mushroom v. Dominick’s Finer Foods*, 635 F. Supp. 1281, 1285 (N.D. Ill.1986).

Courts do not favor the destruction of agreements, but will, if feasible, construe agreements so as to carry into effect the reasonable intention of the parties.

The main thrust of the appellant’s contention is that the trial court failed to consider that there was no “mutual assent” and that Harry Chapman did not “intend” to enter into a binding agreement for the purchase of twenty-one computers. But the trial court held otherwise, and recognized that there was mutual assent.

While a few cases under § 2-204 of the UCC speak in terms of “meeting of the minds,” the actual holdings are consistent with the theory of objective manifestation of assent. An actual mental reservation does not prevent a contract from being formed if there is a manifestation of assent and nothing in Section 2–204 changes this approach. 2 W. HAWKLAND, UCC SERIES, § 2–204:02 at 64 (1982); *Bradford v. Plains Cotton Cooperative Assn.*, 539 F.2d 1249, 1256 (10th Cir.1976).

Tested by these principles, there was, under the circumstances here, “mutual assent” to purchase twenty-one computers. Regardless of Chapman’s intent to purchase a lesser number, the letter of February 23 explicitly contained that number. Although the trial court admitted testimony of Chapman that Purcell did not intend to purchase twenty-one computers, because it had only 15 stores, the trial court found mutual assent and that the contract called for the sale of twenty-one computers. Chapman acknowledged that he signed the letter containing that number; presumably he must have read the letter when it was presented to him. Having signed the letter, he is charged with knowledge of its contents. See 2 ANDERSON, UNIFORM COMMERCIAL CODE, § 2–204:20; 67 AM. JUR. 2D, *Sales*, § 226 at 449; *Crim v. Crim*, 162 Mo. 544, 63 S.W. 489, 491 (1901); 17 AM. JUR. 2D, *Contracts*, § 149 (1964). He admitted he signed the letter; he admitted that he could have changed the letter if he desired to do so but did not. A mere change could have effected a lesser number.

Appellant next contends that the February 23 letter was ambiguous and incomplete so that no contract was made. This contention was rejected by the trial court and we affirm that finding.

Under the UCC, the ultimate test of definiteness with respect to the sale of goods is that there be a reasonably certain basis for giving an appropriate remedy. § 2–204 Official Comment. The fact that a contract for the sale of goods may be open does not void the contract if it can be ascertained from the express or implied provisions.

Section 2–204(3) requires only that, even though one or more of the terms are left open, a contract does not fail if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy. See 67 AM. JUR. 2D, *Sales*, §§ 117, 118 (1985); Official Comment.

Recently we had occasion to consider the definiteness of a price term in an agreement in *Sedmak v. Charlie's Chevrolet, Inc.*, 622 S.W.2d at 694. There we said that “[f]ailure to specify the selling price in dollars and cents did not render the contract void or voidable As long as the parties agreed to a method by which the price was to be determined and as long as the price could be ascertained at the time of performance, the price requirement for a valid and enforceable contract was satisfied.” *Id.* at 697 (holding also that the “quantity” term is a “key provision without which the court cannot reconstruct the contract fairly.”).

In *Allied Disposal v. Bob's Home Service*, 595 S.W.2d 417 (Mo. App. 1980), we held that an “agreement to agree” on price does not preclude the validity of a contract. While we recognized the general rule that an agreement must fix a price or provide a method to ascertain the price in order to form an enforceable contract, we also recognized that where there is no statement at all as to price and the contract has been executed, the law implies a standard of reasonableness. We noted the fact that earlier cases in Missouri on vagueness and indefiniteness have been largely rendered obsolete by the enactment of the Uniform Commercial Code as it pertains to the sale of goods.

In the case at bar, the letter of February 23, 1984 contains all the material and essential terms for a binding agreement. The parties, Brown and Chapman, signed the letter “regarding the purchase” by Purcell of “twenty-one (21) IBM PC’s over the next twelve (12) months.” The long list of omissions suggested by Purcell—ranging from the lack of a total price in the “letter,” and which party is to deliver the computers, to no mention of liquidated damages—does not show that the contract is ambiguous as to be void. Furthermore, there is no requirement to detail and list all the previous conversations in the letter.

Under all the circumstances, we conclude that the trial court did not err in finding that the contract for the sale of computers was not indefinite.

The judgment is affirmed.

Review Question 3. The *Computer Network* court discusses at some length the differences between contract formation under the common law and under the Uniform Commercial Code, with the UCC generally taking a more liberal approach to contract formation. Would the case have come out differently if the common law had applied? What are some specific factual reasons the case might or might not have come out differently?

Review Question 4. Computer Network and Purcell Tire do not seem to have had a *literal* “meeting of the minds” in the formation of their contract. What exactly is the policy justification for binding parties like these to a contract? Wouldn’t it make

more sense for contract formation to be more difficult, so that all parties can be certain of the deal to which they are entering?

Statutory Note. In connection with the *Scoular* case that follows, read UCC §§ 2-205 and 2-206, which create important differences between the UCC and the common law on contracts in the areas of offer, acceptance, and consideration. Section 2-205 also introduces the concept of a “merchant” under the UCC, which we will explore in more detail in the next unit.

SCOULAR CO. v. DENNEY

Court of Appeals of Colorado
151 P.3d 615 (Colo. Ct. App. 2006)

DAILEY, J.

Denney is a grain farmer in Holyoke, Colorado. Scoular is a grain company headquartered in Omaha, Nebraska that operates a grain elevator in Venango, Nebraska. Denney grows, and Scoular buys and resells, millet, a grain used for, among other things, birdfeed.

Denney had had numerous dealings with Scoular in the past. On several occasions, he had sold his grain on a “spot” sale basis, that is, without negotiating a contract beforehand. He simply arrived at the grain elevator with his crop and bargained for and received payment based on the market price prevailing at that time. On other occasions, he entered into “forward contracts” with Scoular, under which he agreed to deliver his crop to the elevator at some later time, for a price that was locked in as of the date the agreement was reached.

On May 30, 2002, Denney and Scoular discussed a forward contract for 15,000 bushels of millet. Although Denney indicated a desire to sell his millet, which had not yet been grown, at \$5 per hundredweight of product, Scoular declared that that price was not then available. Four days later, however, Scoular, relying on Denney’s offer, sold the millet to a buyer who purchased it at a rate sufficient to meet Denney’s price. Scoular’s general manager unsuccessfully tried several times to reach Denney by telephone to inform him of the sale, but Denney was out farming. On June 27, 2002, the general manager spoke with Denney and mailed him a written and signed purchase contract.

Denney did not check his mail. Consequently, he never signed or returned the purchase contract. When the millet was harvested and ready for delivery in the fall of 2002, the market price of millet had trebled. Denney delivered his millet not to Scoular, but to a grain operator in Paoli, Colorado. When Scoular asked why he had

not delivered the millet to it, Denney purportedly remarked that it was “too bad” Scoular did not have a signed contract.

Thereafter, Scoular instituted the present action for monetary damages, based on claims of breach of contract, promissory estoppel, and unjust enrichment.³ After a bench trial, the trial court determined that (1) Denney had entered into and breached an enforceable contract to sell 15,000 bushels of millet to Scoular at \$ 5 per hundred weight of product and (2) Scoular was entitled to recover \$82,500 in damages arising from Denney’s breach. The court did not address Scoular’s alternative theories for relief.

On appeal, Denney contends that the trial court erred in concluding that he had entered into an enforceable contract with Scoular to sell millet. Although a contract is formed when an offer is accepted, *Williams v. Chrysler Ins. Co.*, 928 P.2d 1375, 1379 (Colo. App. 1996), Denney asserts that (1) under UCC § 2-101, et seq., Colorado’s version of the Uniform Commercial Code (UCC), he could not be bound to a contract based only on his oral offer to sell; (2) contrary to the trial court’s conclusion, Scoular’s contracting to sell the millet to a third party did not constitute an acceptance of his offer; and (3) if a contract was entered into, it was not enforceable because it was not in writing and signed by both parties.

Denney contends that, under § 2-205, he could not be bound by what the trial court referred to as a “firm offer” because the offer had not been made in writing. We disagree.

As Denney notes, the purpose of the section is “to modify the former rule which required that ‘firm offers’ be sustained by consideration in order to bind, and to require instead that they must merely be characterized as such and expressed in signed writings.” Section 2-205 cmt. 1. As the language of § 2-205 itself makes clear, as used in the comment, the term “bind” means only to make irrevocable.

Indeed, as noted by one leading treatise, under common law “it was frequently said ‘an offeror can always withdraw an offer if no consideration was received for it.’” 1 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 1-4 (4TH ED. 1995). “Section 2-205 is intended mainly to limit the power of an offeror to withdraw a firm offer when the offeree reasonably relies on the offer’s firmness.” *Id.* § 1-4.

Thus viewed, the purpose of § 2-205 is only to establish a type of offer that, although not supported by consideration, is nonetheless irrevocable; § 2-205 is not intended to provide the exclusive mechanism by which a valid (though perhaps revocable) offer can be made. See 2 LARY LAWRENCE, ANDERSON ON THE UNIFORM

³ [Notice that breach of contract, promissory estoppel, and unjust enrichment are all *alternative* causes of action raised by the plaintiff. Scoular would not ultimately be able to recover under more than one of these claims. Breach of contract is unsurprisingly listed first because it would provide a financially more attractive recovery than the two more “equitable” causes of action. – Eds.]

COMMERCIAL CODE § 2-206:12 (3D ED. 2004) (“The Code does not displace the non-Code law as to what constitutes an offer, which therefore continues under the Code.”).

Here, the trial court found that Denney had made a “firm offer” as that term is employed in the grain industry. In that industry, the term “firm offer” refers to a standing offer by a producer to sell a set amount of bushels, at a set price, for a set delivery date. Consistent with ordinary common law contract principles, and comment 2 to § 2-205, this type of oral offer remains open and viable until the producer revokes it. Section 2-205 cmt. 2 (firm offers made by oral communication and relied upon without more evidence “remain revocable under this Article”); *East Larimer County Water Dist. v. Centric Corp.*, 693 P.2d 1019, 1021 (Colo. Ct. App. 1984) (“an offer to contract may be withdrawn at any time prior to acceptance”).

Thus, we conclude that Denney’s oral offer could, if timely accepted, form the basis of a valid contract.

Denney also contends that the trial court erred when it found that Scoular had accepted his offer. We conclude that a remand for further findings is necessary.

Denney asserts that his offer was not open for acceptance because Scoular had rejected it on May 30, 2002 when Scoular failed then to agree to pay the price he was asking. However, the trial court did not find that Scoular had rejected the offer, or that Scoular had indicated that it would not pay that price. The trial court found only that, on May 30, the requested price was “not then available.”

Indeed, according to the transcript provided by Scoular, on May 30, Scoular’s general manager told Denney only that “at that particular time [he] could not” pay that price, but that he would “work on it [and] see what [he could] do.” In our view, Scoular’s response on May 30 was not, as a matter of law, a rejection of Denney’s offer. *See Collins v. Thompson*, 679 F.2d 168, 171 (9th Cir. 1982) (because offeree’s statement that it would take offer under further advisement was not a rejection of the offer, the offer remained open); Restatement (Second) of Contracts § 38 (1981) (same).

Denney also asserts, and we agree, that the trial court erred in concluding that Scoular accepted his offer when it arranged to sell his millet to another buyer.

Acceptance is defined as words or conduct that, when objectively viewed, manifests an intent to accept the offer. When, under § 2-206(2), an offeree relies on the beginning of performance as the mode of acceptance, the offeree’s actions must be such as to “unambiguously express the offeree’s intention to engage himself.” Section 2-206 cmt. 3. Whether there has been acceptance is determined by an objective or reasonable person standard. *Joseph Heiting & Sons v. Jacks Bean Co.*, 236 Neb. 765, 463 N.W.2d 817, 821 (Neb. 1990).

“The Code, with one exception, does not alter the general rule that communication is required of the acceptance of the offer for a bilateral contract while

it is not required of the acceptance of the offer for a unilateral contract.” 2 LAWRENCE, *supra*, § 2-206:55. The exception to the general rule applies when the offeree relies on the beginning of performance as the mode of acceptance, and, in that instance, the offeree must notify the offeror of the acceptance within a reasonable time. *Id.*

Here, the trial court concluded that “the contract was made [by the] ‘acceptance’ of the firm offer of Mr. Denney when Scoular sold Mr. Denney’s millet on June 3, 2002.” In our view, however, Scoular’s act in contracting to sell millet to a third party did not constitute acceptance.

We reject the notion that Scoular’s contract with a third party effected an acceptance, either on the ground that it constituted performance in response to an offer for a unilateral contract (thus, requiring no further notice to Denney) or on the ground that it was, under § 2-206(2), the beginning of performance under a bilateral contract (allowing for a delayed notice to Denney).

An offer requesting a return performance rather than a promise to perform is a unilateral contract. Here, Denney did not ask Scoular to broker a sale of his millet to another. He offered to sell his millet to Scoular, and the performance he desired was payment of money. Inasmuch as Scoular did not immediately pay Denney as a result of its contract with the third party, Scoular cannot be held to have rendered performance constituting acceptance of an offer for a unilateral contract.

Similarly, because Scoular did not begin paying Denney as a result of its contract with the third party, Scoular cannot be held to have begun the performance that would have constituted acceptance of an offer to enter into a bilateral contract.

Further, even if Scoular’s contracting with the third party could be considered “beginning performance” (that is, setting up the circumstances to make payment possible) in response to an offer for a bilateral contract, we would nonetheless conclude that it would not qualify as “acceptance” under § 2-206(2).

Here, the record reveals that Scoular deals with a great number of farmers and in vast amounts of grain. As pertinent here, Scoular did nothing in or with the contract with the third party to earmark Denney’s millet as the source of the millet sold there. Viewed from the perspective of an objective, reasonable person, Scoular was free to use, or plan on using, any number of farmers’ millet to satisfy the demands of the contract with the third party. Under the circumstances, we conclude that the transaction with the third party was too open-ended to constitute an unambiguous expression of intent on Scoular’s part to be bound to a contract with Denney.

This conclusion, however, does not end our inquiry, for the limited record presented to us on appeal suggests that Scoular accepted Denney’s offer during a telephone conversation on June 27, 2002. According to the testimony of Scoular’s general manager, an agreement between the parties was reached over the phone. And following the conversation, Scoular sent Denney a written purchase contract, on the

face of which appears the notation, “Thanks Doug!” above the signature of Scoular’s general manager.

The trial court made no explicit findings regarding the contents of the telephone conversation. The court found only that the purchase contract was a confirmation of the contract discussed over the phone. Arguably, in so finding, the trial court implicitly determined that, during the phone conversation, Scoular expressed its assent to, and thus accepted, Denney’s offer. However, in view of the court’s finding that the contract had been formed at an earlier time, as a result of Scoular’s conduct, the implication is too tenuous to uphold the trial court’s judgment with any degree of confidence. Consequently, a remand is necessary for the trial court to determine whether, during the phone conversation, Scoular accepted or Denney revoked the offer.

Review Question 5. Having read *Scoular Co. v. Denney*, can you identify the specific rules under the common law of contracts that are changed by UCC §§ 2-205 and 2-206? How exactly does the UCC change those rules? How would the case come out if the common law applied? Be prepared to tell your classmates—and your professor—your answer to these questions. Understanding the distinction may help you later.

Review Question 6. Do you think either Scoular or Denney were acting unfairly or opportunistically in the course their transaction? Did the UCC rules *prevent* or *enable* opportunistic behavior in this case? Should the law care about opportunistic behavior one way or the other?

Problems

Problem 10.1

Which of the following things qualify as “goods” such that their sale would be governed by UCC Article 2? Be prepared to identify the statutory reason why each of the following does or does not qualify. You will find UCC §§ 2-105 and 2-107 especially useful here.

Farm

Condominium

Automobile

Book

Copyright license

Personal check
Tree in the ground
Hotel room
Concert ticket
Natural gas in the ground
Natural gas in the pipe
“Doublewide” mobile home
McDonald’s hamburger
McDonalds franchise
E-book
Haircut
Legal services
€50,000
Restaurant meal
Lottery ticket
Music download
Custom-made boots
Electricity

Problem 10.2

Seller is a software company that has a professional suite of software for law office operations. Purchasers can either get the software mailed to them on CDs for \$1,099, or can download the software from the Web for \$999. Lawyer downloads the Web-based software and pays the money. Unfortunately, the software has a defect that causes Lawyer’s entire system to crash, causing serious damage and losses to his law practice. Lawyer wants to sue Seller. In particular, Lawyer wants to argue that his software purchase is an Article 2 transaction because Article 2 provides better implied warranties (see UCC section 2-314 as an example) than does the common law.

What is Lawyer’s argument that the software purchase was a sale of “goods” for purposes of UCC Article 2? What is Seller’s argument that the purchase was not a sale of goods? Be sure to use UCC § 2-105(1) in both sides’ arguments.

Problem 10.3

On June 1, the sales director of Nanakuli Asphalt sent an email message to Star Paving saying as follows: "Following up on our conversation yesterday on the Montecito job, we are offering you 1,500 cubic yards of HMA asphalt (approx. 3,000 tons) at \$75/ton, loaded on your trucks at our facility. We will keep this offer open until June 7. Please let us know ASAP. Thanks for your business!" The sales director's e-mail gave his name on the "from" line but did not contain an e-mail signature block, and the body of the email contained the Nanakuli logo and his electronic business card. On June 4, Nanakuli's sales director sent a new email, saying, "We regret that a sudden price increase from our oil supplier means we have to withdraw our quote of June 1. We can provide the asphalt, but the new price will be \$82/ton. Sorry for any inconvenience." Star gets this shortly after it is sent. Nevertheless, on June 6, Star sends a message purporting to accept the June 1 offer. Nanakuli refuses.

Star ultimately pays the \$82/ton price, but later sues for a refund of \$7/ton on the 3,000 tons purchased, claiming Nanakuli made an irrevocable offer that it accepted, and therefore that there was a contract at \$75/ton. What result under the UCC? Consider UCC §§ 2-204, 2-205, and 2-206 in connection with this problem.

Unit 11: Uniform Commercial Code – Merchants and Terms

ALTERNATIVE REGIMES

Part Two

FOCUS OF THIS UNIT

Article 2 of the Uniform Commercial Code applies to all sales of goods, even if (for example) you sell your classmate a used comic book for one dollar. As to its *applicability*, the UCC does not have a minimum price or any particular qualifications for buyers or sellers. The transaction need only be one in which title to goods passes from the seller to the buyer for a price. That being said, Article 2 does contain several special rules that apply only to *merchants*. This unit will introduce you to the concept and some of the implications of a there being a UCC “merchant” on one or both sides of a sales transaction. We will also consider a topic that has been the bane of generations of students (and professors) of American contract law—the so-called “battle of the forms” under UCC § 2-207. Suffice it to say for now that section 2-207 throws out the “last shot rule” of common-law contract formation and replaces it with . . . something different. It is a little bit complicated.

Merchants and Additional Standards. A recurring tension in American law— not just in contract law—is the question of whether the law should treat all parties the same regardless of their knowledge or sophistication. The question is frequently resolved both ways. A healthy dose of equal treatment is embodied in Theodore Roosevelt’s famous declaration that “no man is above the law and no man is below it.” On the other hand, some situations seem to call for recognition that some parties are in a position where holding them to a higher standard is reasonable, reflecting the famous Biblical admonition that “to whom much is given, from him much will be required.” Or, as football coach Tony Dungy put it, “I need to treat everybody fairly, but fair doesn’t always mean equal.”

Article 2 addresses this tension by creating a special category of buyers and sellers known as “merchants,” essentially people or organizations who regularly deal in the goods or practices of selling goods. For example, if law professor Snyder sells his used car to law professor Burge, the transaction is governed by the UCC, but

neither party is a merchant. Snyder is not a car dealer and Burge does not buy cars except for personal use. If, however, Burge buys his vehicle off the lot at Snyder's Used Car Mart, Snyder in that case qualifies as a merchant while Burge does not. Taking the facts one step further, suppose that Burge is actually a used car buyer for the local auto auction. In that case, the sale occurred "between merchants" because both sides both sides of the car sale qualify as merchants. UCC § 2-104 defines the term "merchant" in subsection (1), while subsection (3) describes when a transaction is "between merchants." Both concepts will show up in the cases in this unit, so you would do well to examine UCC § 2-104 briefly before continuing.

In this unit, we will see two of the instances where merchant status matters under Article 2. The first is the creation of a warranty that goods sold by a merchant are of a certain quality, a warranty known as the "implied warranty of merchantability," contained in UCC § 2-314. A second place where merchants make an appearance in this unit is in section 2-207, the other major topic in this unit.

Shattering the Mirror Image Rule. Section 2-207, it is fair to say, changes everything that you think you know (and we just taught you) about the mirror-image rule under the common-law of contracts. Indeed, one could fairly say that section 2-207 smashes the mirror into thousands of shards capable of bloodying the hands that touch them. Section 2-207 was drafted to deal with a real problem under the common law. Because the mirror-image rule requires that contracting parties agree to the exact same terms in order to form a contract, the last party to propose terms before performance of the contract always controlled the terms of the deal. Because the last party gets the upper hand in dictating contract terms in this situation, this mirror-image requirement is also frequently referred to as the "last shot rule." While that was not necessarily a fair way to select among conflicting terms on which parties did not agree, it at least has the virtue of being simple. Section 2-207, as you will see, replaces mirror-image offer and acceptance with a regime where non-identical responses to an offer are treated as acceptance of the offer, along with proposals to modify the contract. At common law, of course, a non-identical acceptance would be treated as a counter-offer. Section 2-207 has proved to be one of the most controversial contract-law innovations in UCC Article 2, as well as one of the more challenging concepts for students to understand.

As in the previous unit, we have edited citations to the Uniform Commercial Code in the cases that follow so that they will refer you to the "Official" version of the UCC found in many statutory supplements (or in online databases, including the free-access Legal Information Institute: <https://www.law.cornell.edu/ucc>). We believe you will find it helpful to see the statute separately, even where courts provide you with a lengthy quotation. Doing so will enable you to see the larger context in which particular sections of the code operate.

Cases and Materials

A. Merchants

FOLEY v. DAYTON BANK & TRUST

Court of Appeals of Tennessee
696 S.W.2d 356 (Tenn. Ct. App. 1985)

CRAWFORD, Judge.

In this non-jury case, plaintiffs, Marvin A. Foley, William E. Ball, III, and Johanna M. Foley, buyers of a used truck from defendant, Dayton Bank and Trust, appeal from the order of the Chancery Court dismissing their suit to rescind the transaction. Plaintiffs' complaint alleges in substance that they purchased a 1977 International Transtar II truck from Dayton; that Mayfield, the representative of the bank handling the transaction, "stated emphatically that the motor vehicle was 'in good mechanical condition' and in particular assured the plaintiff the engine in the vehicle was in excellent condition at the time of the purchase;" and that plaintiff relied on Mayfield's representation and expended large sums to prepare the vehicle for its proposed use. The complaint further avers that the vehicle broke down as the result of engine trouble after less than 250 miles of operation, thus substantially impairing the vehicle's value, and that repairing the engine would require the expenditure of at least \$6,400. Plaintiffs' complaint states that they rightfully revoked acceptance and now seek the return of all monies paid plus other described damages.

The record reflects that the bank had previously financed the large trailer-type truck in question and had acquired title thereto after repossession pursuant to its financing papers. The truck had been on the defendant's lot for several months prior to its purchase by plaintiffs. It was eight years old and had been driven approximately 447,161 miles. Although the defendant bank engaged in the business of financing automobiles and related-type motor vehicles, it did not normally finance trucks of this type.

[The court first affirms the trial court finding that Dayton Bank & Trust did not create an "express warranty" by any statements about the condition and quality of the truck engine.]

Plaintiffs now assert that there was an implied warranty of merchantability as provided in UCC 2-314 which states in part:

(1) Unless excluded or modified (§2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind

[T]he plain reading of the statute excludes the finding of any implied warranty since UCC § 2–314 (1979) applies only to sales made by a “merchant with respect to goods of that kind.” UCC § 2–104 defines merchant as:

“Merchant” means a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.

From the undisputed testimony in the record, it is clear that the defendants, Dayton Bank & Trust Company and Homer Mayfield, are not merchants within the meaning of the statute.

Review Question 1. Courts are not always helpful in articulating their reasoning, and here the *Foley* court seemed to think it self-evident why Dayton Bank & Trust was not a merchant against whom the implied warranty of merchantability would operate. Why exactly is a bank—generally considered a sophisticated commercial party—not a “merchant” for purposes of this case? Carefully read the quoted text of the definition of “merchant” in UCC § 2-104(1).

Review Question 2. Burge is annoyingly fond of a sing-song saying that “only a **merchant** has the **ability** to imply the warranty of merchantability.” Is that statement correct? Read UCC § 2-314 and see if you can explain what *quality* of goods are implied when goods are sold by a merchant. Can you see why parties get in legal battles over whether a seller is or is not a merchant? The *Gared Holdings* case that follows may help you answer this question.

GARED HOLDINGS, LLC v. BEST BOLT PRODUCTS, INC.

Court of Appeals of Indiana.
991 N.E.2d 1005 (Ind. Ct. App. 2013)

CRONE, J.

Facts and Procedural History

Best Bolt primarily sells fasteners, such as “bolts, nuts and screws and miscellaneous hardware items.” Best Bolt is a distributor; it does not manufacture the products that it sells. Sometime in 2006, Curtis Sparks, a salesman for Best Bolt, noticed that Gared Holdings had playground equipment outside its facility and

thought that Gared could be a potential customer. Sparks stopped in and introduced himself. He was directed to Lori Turner, a purchasing manager who is responsible for ordering parts that Gared uses in the products that they manufacture. Sparks began stopping in every four weeks in hopes of establishing a business relationship with Gared. Gared eventually placed orders for cable clamps, clevis pins, and D rings.

At issue in this case are two orders that Gared placed for pulleys. Gared uses pulleys in the basketball goal systems that it manufactures. The basketball goals are designed to hang from the ceiling and can be raised and lowered. The facts favorable to the judgment reflect that, during one of Sparks's regular sales calls in 2006, Turner asked him if Best Bolt could supply pulleys. Turner indicated that their current supplier, Inventory Sales, was going to raise the price, and she was hoping to find a less expensive pulley. Turner also indicated that there was a problem with cables slipping off the wheel and becoming lodged between the wheel and the side plate. Turner provided samples pulleys in two sizes, #3 and #5. Sparks told Turner, "I'll see what I can do." Sparks did not tell Turner that neither he personally nor Best Bolt generally had ever sold pulleys before.

Sparks requested a drawing, but Turner indicated that they did not have one. Gared did not provide detailed specifications for the pulleys, but did indicate that the #5 pulleys needed to be rated at 1,550 pounds, withstand a standard pull test of 8,000 pounds, and withstand a side pull test of 5000 pounds. At some point during the design process, Gared also requested that the pulleys be fastened together with nylocks rather than rivets.

Best Bolt decided to source the pulleys through Dakota Engineering, which would manufacture the pulleys in China. The sample pulleys from Gared were sent to Dakota's engineer in China, who sent back a sample. Joe Connerly, the engineering manager for Gared, examined the samples, measured the diameter, and looked for a proper gap between the wheel and side plate. He did not take the samples apart because they "appeared to be correct." Although he could not tell for sure without taking the pulley apart, he believed that the pulley contained a lubricated bushing because there was a small gap on each side of the wheel between the wheel and the side plate. However, the sample pulleys did not actually have a bushing.

On June 27, 2007, Turner placed an order with Best Bolt for 4,995 #5 pulleys. On April 14, 2008, Turner placed an order for 2,000 #3 pulleys and an additional 5,000 #5 pulleys. The purchase order requested that Best Bolt send samples of each for testing, although it is unclear whether Best Bolt sent the samples and, if so, whether Gared had any testing done.

In the fall of 2008, one of Gared's customers reported that a basketball goal had fallen part way to the floor. Connerly examined the goal system and determined that the pulley had stopped turning. Because the pulley was not moving with the cable, the cable eventually became frayed and snapped. Connerly took the pulley

apart and realized for the first time that the pulley did not have a bushing and was not lubricated in any way. Without any lubrication, the wheel and axle had become “frozen” together. Connerly conducted a cycling test on two Best Bolt pulleys, which involves repeatedly lifting and lowering a load. The pulleys each seized up after twenty-one cycles.

Gared contacted Best Bolt about the problem, and Best Bolt proposed applying a spray lubricant to the pulleys. Connerly felt that this solution was inadequate because there was no guarantee that the spray could be accurately applied to the axle, the spray would likely need to be applied repeatedly, and the process would require a lot of manpower. Gared wanted Best Bolt to accept the return of the unused pulleys and pay for the replacement of the pulleys that had been already been used, but Best Bolt refused. Concerned that the basketball goal systems incorporating the Best Bolt pulley posed a safety hazard, Gared decided to replace the pulleys with a more expensive pulley manufactured by Block Division (“Block”). Gared refused to pay for the second order of Best Bolt pulleys and also refused delivery of an order of clevis pins.

On September 10, 2009, Gared filed a complaint against Best Bolt stating five claims [including] breach of the implied warranty of merchantability. On November 4, 2009, Best Bolt filed an answer and a counterclaim seeking payment for the second order of pulleys and the clevis pins.

A bench trial was held on June 5 through 7, 2012. It was undisputed that Gared did not specifically request that the pulley have a lubricated bushing. However, Gared attempted to show that a lubricated bushing was a standard or essential component of a pulley, and therefore a buyer would not typically need to make a specific request for a lubricated bushing. Connerly testified that he considered pulleys to be an “off-the-shelf” item that could be purchased from a catalog without needing to provide a drawing. He testified that a buyer would not have to specify that it have a lubricated bushing or bearing because “[t]hat’s standard in the industry.” Connerly stated that the pulleys that Gared has purchased from suppliers other than Best Bolt have all had lubricated bushings and did not have problems with seizing up. Connerly testified that a pulley without a lubricated bushing could work only “[f]or a short period of time,” but not for the “expected life of the . . . pulley.” He stated that the Best Bolt pulleys started failing less than a year after the basketball goal systems were sold, and he would expect a pulley to last more than a year. Connerly testified that he had not opted to perform a cycle test on the pulleys before approving them for purchase because “the pulleys that . . . are normally manufactured . . . it’s a requirement of that pulley to be able to rotate. So when you purchase a pulley you expect it to be able to rotate and it was really no reason to do a cycle test at that point in time.” After the problem arose with the Best Bolt pulleys, Connerly made a detailed drawing of a pulley “so that if we chose to go to . . . another supplier who was not a normal manufacturer of pulley[s] they would understand the requirements of

manufacturing a pulley.” However, when Gared started purchasing pulleys from Block, it did not provide the drawing to Block because Block had its own drawing.

Turner likewise testified that the pulleys that Gared had purchased from other manufacturers all had lubricated bushings. She said that at the time that she started ordering from Best Bolt, Gared did not have a specification sheet for the # 5 pulley because “it was a standard item. There was nothing custom about it....” She did not think that it was necessary to specify that the pulleys needed to have a lubricated bushing because they were an off-the-shelf item and always have a lubricated bushing.

Kevin Needier, the operations manager of Gared, also characterized pulleys as an off-the-shelf part. Needier also testified that the pulleys that Gared had purchased from other manufacturers all had lubricated bushings. He stated that Gared had not had to ask Inventory Sales or Block to provide a lubricated bushing.

Implied Warranty of Merchantability

The trial court ruled that the implied warranty of merchantability did not apply because Best Bolt is not a merchant as that term is defined by Indiana’s version of the Uniform Commercial Code. Section 2-314(1) provides: “Unless excluded or modified [under § 2-316], a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind.” The comments to this section state, “A person making an isolated sale of goods is not a ‘merchant’ within the meaning of the full scope of this section and, thus, no warranty of merchantability would apply.” UCC § 2-314, cmt. 3. Section 2-104 defines a “merchant” as “a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction.” The comments to this section state that, in the context of the implied warranty of merchantability, the term “merchant” is restricted “to a much smaller group than everyone who is engaged in business and requires a professional status as to particular kinds of goods.” UCC § 2-104, cmt. 2. At the same time, our cases hold that the implied warranty of merchantability “is imposed by operation of law for the protection of the buyer and must be liberally construed in favor of the buyer.” *Frantz v. Cantrell*, 711 N.E.2d 856, 859 (Ind.Ct.App.1999).

Regarding Gared’s claim for breach of the warranty of merchantability, the court’s order states: “The evidence demonstrated that this was the first and last sale of pulleys by Best Bolt. In fact Best Bolt was merely the distributor and Gared was aware that Best Bolt was trying to find a company to manufacture the pulleys at a price acceptable to Gared.” The term “merchant” is not limited to manufacturers, and Best Bolt does not cite any authority that supports the proposition that a distributor cannot be a merchant. Furthermore, the court’s order is incorrect insofar as it states that Best Bolt made only one sale of pulleys. Best Bolt made two sales to Gared, and

we also note that Best Bolt's vice president testified that Best Bolt would be willing to continue selling pulleys if it had a buyer.

Gared argues that if the trial court's "interpretation of the definition of 'merchant' is accepted then a seller such as Defendant which sells a wide variety of industrial products would get a free pass on its first sale of any item that it sold." Although the number or frequency of sales surely is relevant to the question of whether a seller is a merchant, we are inclined to agree that a small number of sales is not necessarily conclusive proof that the seller is not a merchant; rather, it could be indicative that the seller simply has a relatively new product or a limited market for a particular product.

Gared argues that this case is similar to *Frantz*. In that case, a homeowner sued Joseph Frantz and Frantz Lumber Company over defective shingles that were installed on his roof. The opinion treats Frantz and the lumber company as a single entity, although the opinion is somewhat vague as to their relationship and the lumber company's role in the work that was performed on the roof. However, the ultimate holding appears to be that the lumber company was found to be a merchant of shingles because it represented that it sold "all kinds of building material" and appeared knowledgeable about roofing materials. *Frantz*, 711 N.E.2d at 859. Similarly, Best Bolt sold a variety of hardware products, and pulleys are in the same general line of business. On the other hand, *Frantz* does not shed much light on the issue of whether a seller who has made only a few sales of a product may be considered a merchant.

Frantz is one of only a few Indiana cases to discuss the meaning of the term merchant; therefore, we find it helpful to look to cases from other jurisdictions that have addressed the issue. One commentator states:

A single, isolated transaction is not enough to establish that a merchant deals in goods of that kind, but one can be found to be a merchant for this purpose if he customarily sells a general line of goods related to the item in question, even though that specific item is being sold for the first time.

HAWKLAND'S UNIFORM COMMERCIAL CODE SERIES § 2-314:2 (West 2012) (footnotes omitted). *Wood Products v. CMI Corp.*, 651 F. Supp. 641 (D. Md.1986), is cited in support.

Wood Products concerned a furnace that was originally designed by James Angelo to convert sawdust and other wood waste products into charcoal. CMI Corporation obtained the rights to manufacture the Angelo furnace and sold one to Wood Products, a company primarily engaged in milling and selling lumber. CMI altered the design of the furnace to incorporate a larger drum. Wood Products began experiencing problems with the furnace almost immediately, most of which stemmed from the fact that the drum was too large and too thin. Wood Products sued CMI on

several theories, including breach of the warranty of merchantability. CMI argued that it was not a merchant with respect to goods of the kind due to “the experimental nature of the furnace.” The court disagreed, noting that CMI “was then manufacturing (for the use of one of its affiliates) a similar furnace and it has manufactured another since.” *See also Geo. Byers Sons, Inc. v. E. Europe Import Export, Inc.*, 488 F. Supp. 574, 580 (D. Md.1980) (company that was trying to establish an American market for East European vehicles was held to be a merchant of East German motorcycles even though its only other sale at the time was a single Romanian jeep).

Best Bolt argues that this case is similar to *Fred J. Moore, Inc. v. Schinmann*, 700 P.2d 754 (Wash. Ct. App. 1985). In that case, the Moore family was in the business of growing mint for the production of mint oil. The Moores were approached by the Schinmanns, who wished to buy spearmint roots. The Moores had never previously sold mint roots, but ultimately agreed to sell roots to the Schinmanns. When the mint roots turned out to be a mixture of spearmint and peppermint, the Schinmanns sued the Moores on several theories, including the warranty of merchantability. The court held that the Moores were not merchants with respect to mint roots because “this was the first and only sale of roots by the Moores.” Moore involved a single sale, and there was no evidence to suggest that the Moores were interested in continuing to sell mint roots. The case at bar is more similar to *Wood Products* and *Geo. Byers*, where the sellers had made a few sales and there was evidence to suggest that the sellers were attempting to develop a new market.

We conclude that the trial court erred by focusing on the fact that Best Bolt was a distributor rather than a manufacturer because that fact is not relevant to the analysis. We also conclude that the trial court erred by characterizing Best Bolt’s experience with pulleys as a single sale where the undisputed evidence reflects that Best Bolt made two sales and was willing to continue selling pulleys if it had a buyer. *See McHugh v. Carlton*, 369 F. Supp. 1271, 1277 (D.S.C.1974) (service station that would procure and sell recapped tires upon request of customer was a merchant of recapped tires even though service station did not regularly stock and sell recapped tires). Based on the authorities that we have examined, we conclude that Best Bolt is a merchant with respect to pulleys.

We turn then to whether Best Bolt breached the implied warranty of merchantability. Indiana UCC § 2–314(2) provides:

Goods to be merchantable must at least be such as:

- (a) pass without objection in the trade under the contract description;
and
- (b) in the case of fungible goods, are of fair, average quality within the description; and

- (c) are fit for the ordinary purposes for which such goods are used; and
- (d) run, within the variations permitted by the agreement, of even kind, quality, and quantity within each unit and among all units involved; and
- (e) are adequately contained, packaged, and labeled as the agreement may require; and
- (f) conform to the promises or affirmations of fact made on the container or label if any.

The undisputed evidence establishes that the ordinary purpose of a pulley is to bear a dynamic load. Several of Gared's witnesses testified that a lubricated bushing was an essential part of a pulley, that lubricated bushings were standard in the industry, that it was unreasonable to make pulleys without lubricated bushings, and that a pulley without a lubricated bushing would inevitably have a short useful life. On the other hand, Hylton testified that he was aware of pulleys made without lubricated bushings and opined that "under certain load—static load or . . . very low dynamic loads a non[-]bushed pulley could work just as well as a bushed pulley." Because the evidence is in conflict and the trial court did not reach the issue, we remand for the trial court to determine whether Best Bolt breached the warranty of merchantability.

Conclusion

We conclude that the trial court erred in ruling that Best Bolt was not a merchant. We therefore remand for the trial court to determine whether Best Bolt breached the implied warranty of merchantability.

Review Question 3. Why exactly did Best Bolt qualify as a merchant, especially given that it does not manufacture the fasteners that it sold? UCC section 2-314(2) lists seven aspects of what it means for goods to be "merchantable." If you were defending Best Bolt in its case remanded to the trial court, which of the seven items would you be most concerned that your client potentially breached, given the evidence described in the case?

Review Question 4. The implied warranty of merchantability is so called because it is implied by law into the contract, even if neither party intends such a warranty. Suppose that, after the *Gared Holdings* case, manufacturer Best Bolt approaches you about getting rid of the implied warranty of merchantability in its contracts. Is there anything you could possibly do about that? Consult UCC § 2-316 in connection with your answer.

B. Conflicting Terms in Offer and Acceptance

COMMERCE & INDUSTRY INS. CO. v. BAYER CORP.

Supreme Judicial Court of Massachusetts
433 Mass. 388, 742 N.E.2d 567 (2001)

GREANEY, J.

We granted the application for direct appellate review of the defendant, Bayer Corporation (Bayer), to determine the enforceability of an arbitration provision appearing in the plaintiff's, Malden Mills Industries, Inc. (Malden Mills), orders purchasing materials from Bayer. In a written decision, a judge in the Superior Court concluded that the provision was not enforceable. An order entered denying Bayer's motion to compel arbitration and to stay further litigation against it. We affirm the order.

The background of the case is as follows. Malden Mills manufactures internationally-known apparel fabrics and other textiles. On December 11, 1995, an explosion and fire destroyed several Malden Mills's buildings at its manufacturing facility. Subsequently, Malden Mills and its property insurers, the plaintiffs Commerce and Industry Insurance Company and Federal Insurance Company, commenced suit in the Superior Court against numerous defendants, including Bayer. In their complaint, the plaintiffs allege, insofar as relevant here, that the cause of the fire was the ignition, by static electrical discharge, of nylon tow (also known as bulk nylon fiber), which was sold by Bayer to Malden Mills and used by Malden Mills to manufacture "flocked fabric," a fabric used primarily for upholstery application.

Malden Mills initiated purchases of nylon tow from Bayer either by sending its standard form purchase order to Bayer, or by placing a telephone order to Bayer, followed by a standard form purchase order. Each of Malden Mills's purchase orders contained, on the reverse side, as one of its "terms and conditions," an arbitration provision stating:

Any controversy arising out of or relating to this contract shall be settled by arbitration in the City of New York or Boston as [Malden Mills] shall determine in accordance with the Rules then obtaining of the American Arbitration Association or the General Arbitration Council of the Textile Industry, as [Malden Mills] shall determine.

Another "term and condition" appearing in paragraph one on the reverse side of each purchase order provides:

This purchase order represents the entire agreement between both parties, notwithstanding any Seller's order form, whether sent before or after the sending of this purchase order, and this document cannot be modified except in writing and signed by an authorized representative of the buyer.

In response, Bayer transmitted Malden Mills's purchase orders to the manufacturer with instructions, in most instances, that the nylon tow was to be shipped directly to Malden Mills. Thereafter, Bayer prepared and sent Malden Mills an invoice. Each of the Bayer invoices contained the following language on its face, located at the bottom of the form in capital letters:

TERMS AND CONDITIONS: NOTWITHSTANDING ANY CONTRARY OR INCONSISTENT CONDITIONS THAT MAY BE EMBODIED IN YOUR PURCHASE ORDER, YOUR ORDER IS ACCEPTED SUBJECT TO THE PRICES, TERMS AND CONDITIONS OF THE MUTUALLY EXECUTED CONTRACT BETWEEN US, OR, IF NO SUCH CONTRACT EXISTS, YOUR ORDER IS ACCEPTED SUBJECT TO OUR REGULAR SCHEDULED PRICE AND TERMS IN EFFECT AT TIME OF SHIPMENT AND SUBJECT TO THE TERMS AND CONDITIONS PRINTED ON THE REVERSE SIDE HEREOF.

The following "condition" appears in paragraph fourteen on the reverse side of each invoice:

This document is not an Expression of Acceptance or a Confirmation document as contemplated in Section 2-207 of the Uniform Commercial Code. The acceptance of any order entered by [Malden Mills] is expressly conditioned on [Malden Mills's] assent to any additional or conflicting terms contained herein.

Malden Mills usually remitted payment to Bayer within thirty days of receiving an invoice.

Based on the arbitration provision in Malden Mills's purchase orders, Bayer demanded that Malden Mills arbitrate its claims against Bayer. After Malden Mills refused, Bayer moved to compel arbitration and to stay the litigation against it. The judge denied Bayer's motion, concluding, under § 2-207 of the Massachusetts enactment of the Uniform Commercial Code, that the parties' conduct, as opposed to their writings, established a contract. As to whether the arbitration provision was an enforceable term of the parties' contract, the judge concluded that subsection (3) of § 2-207 governed, and, pursuant thereto, the arbitration provision was not enforceable because the parties had not agreed in their writings to arbitrate. Finally, the judge rejected Bayer's argument that the plaintiffs should be equitably estopped from refusing to proceed under the arbitration provision.

This case presents a dispute arising from what has been styled a typical "battle of the forms" sale, in which a buyer and a seller each attempt to consummate a commercial transaction through the exchange of self-serving preprinted forms that clash, and contradict each other, on both material and minor terms. See 1 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 1-3, at 6-7 (4th ed. 1995). Here, Malden Mills's form, a purchase order, contains an arbitration provision,

and Bayer's form, a seller's invoice, is silent on how the parties will resolve any disputes. Oddly enough, the buyer, Malden Mills, the party proposing the arbitration provision, and its insurers, now seek to avoid an arbitral forum.

Section 2-207 was enacted with the expectation of creating an orderly mechanism to resolve commercial disputes resulting from a "battle of the forms." The section has been characterized as "an amphibious tank that was originally designed to fight in the swamps, but was sent to fight in the desert." WHITE & SUMMERS, *supra*, at § 1-3, at 8. Section 2-207 sets forth rules and principles concerning contract formation and the procedures for determining the terms of a contract. As to contract formation, under § 2-207, there are essentially three ways by which a contract may be formed. "First, if the parties exchange forms with divergent terms, yet the seller's invoice does not state that its acceptance is made 'expressly conditional' on the buyer's assent to any additional or different terms in the invoice, a contract is formed [under subsection (1) of § 2-207]." *JOM, Inc. v. Adell Plastics, Inc.*, 193 F.3d 47, 53 (1st Cir. 1999). "Second, if the seller does make its acceptance 'expressly conditional' on the buyer's assent to any additional or divergent terms in the seller's invoice, the invoice is merely a counteroffer, and a contract is formed [under subsection (1) of § 2-207] only when the buyer expresses its affirmative acceptance of the seller's counteroffer." *Id.* Third, "where for any reason the exchange of forms does not result in contract formation (e.g., the buyer 'expressly limits acceptance to the terms of [its offer]' under § 2-207(2)(a), or the buyer does not accept the seller's counteroffer under the second clause of § 2-207[1]), a contract nonetheless is formed [under subsection (3) of § 2-207] if their subsequent conduct—for instance, the seller ships and the buyer accepts the goods—demonstrates that the parties believed that a binding agreement had been formed." *Id.* at 54.

Bayer correctly concedes that its contract with Malden Mills resulted from the parties' conduct, and, thus, was formed pursuant to subsection (3) of § 2-207. A contract never came into being under subsection (1) of § 2-207 because (1) paragraph fourteen on the reverse side of Bayer's invoices expressly conditioned acceptance on Malden Mills's assent to "additional or different" terms, and (2) Malden Mills never expressed "affirmative acceptance" of any of Bayer's invoices. In addition, the exchange of forms between Malden Mills and Bayer did not result in a contract because Malden Mills, by means of language in paragraph one of its purchase orders, expressly limited Bayer's acceptance to the terms of Malden Mills's offers.

Although Bayer acknowledges that its contract with Malden Mills was formed under subsection (3) of § 2-207, it nonetheless argues, relying on language in both *JOM, supra* at 55, and official comment 6 to § 2-207 of the Code, that the terms of the contract are determined through an application of the principles in subsection (2) of § 2-207. Under this analysis, Bayer asserts that the arbitration provision became part of the parties' contract because it was not a "material alteration," and to include the

provision would cause no “surprise or hardship” to the plaintiffs. This analysis is incorrect.

Bayer ignores the significance of the method of contract formation in determining the terms of a contract. See WHITE & SUMMERS, *supra*, at § 1-3, at 19-20 (discussing three routes of contract formation under § 2-207, and noting “the terms of any resulting contracts will vary, depending on which route to contract formation a court adopts”). Where a contract is formed by the parties’ conduct (as opposed to writings), as is the case here, the terms of the contract are determined exclusively by subsection (3) of § 2-207. 2 RONALD A. ANDERSON, UNIFORM COMMERCIAL CODE § 2-207:14, at 568; § 2-207:28, at 574-575; § 2-207:47, at 584; § 2-207:146, at 640 (3d ed. rev. 1997). Official comment 7, which Bayer overlooks, expressly directs as much:

In many cases, as where goods are shipped, accepted and paid for before any dispute arises, there is no question whether a contract has been made. In such cases, where the writings of the parties do not establish a contract, it is not necessary to determine which act or document constituted the offer and which the acceptance. . . . The only question is what terms are included in the contract, and subsection [3] furnishes the governing rule”). Under subsection (3) of § 2-207, “the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this chapter.

In this respect, one commentator has aptly referred to subsection (3) of § 2-207 as the “fall-back” rule. See 1 THOMAS M. QUINN, UNIFORM COMMERCIAL CODE COMMENTARY AND LAW DIGEST ¶ 2-207[A][14], at 2-134 (2d ed. 1991). Under this rule, the Code accepts “common terms but rejects all the rest.” While this approach “serves to leave many matters uncovered,” terms may be filled by “recourse to usages of trade or course of dealing under § 1-205 or, perhaps, the gap filling provisions of §§ 2-300s.”

Contrary to Bayer’s contentions, subsection (2) of § 2-207 is not applicable for several reasons. First, subsection (2) instructs on how to ascertain the terms of a contract when the contract is formed either by the parties’ writings or by a party’s written confirmation of an oral contract, situations not present here (the parties’ contract was formed by their conduct). Second, the rules set forth in subsection (2), concerning how the terms of a contract between merchants are determined, apply only when the acceptance or written confirmation contains “additional or different terms,” a situation also not present here (Bayer’s invoice is silent concerning how to resolve disputes).

Where the writings do not form a contract, subsection (3) states its own criteria—“those terms on which the writings agree” plus any terms that would be provided by other Code sections.

Thus, the judge correctly concluded, under subsection (3) of § 2-207, that the arbitration provision in Malden Mills's purchase orders did not become a term of the parties' contract. The arbitration provision was not common to both Malden Mills's purchase orders and Bayer's invoices. Because Bayer concedes that it never previously arbitrated a dispute with Malden Mills, we reject Bayer's claim that the parties' course of dealing requires us to enforce the arbitration provision.

Review Question 5. Do you need an aspirin after reading the *Bayer* case? Grab a sharp pencil and work your way through the formation processes under section 2-207 in three situations where the parties' forms do not match: (1) The second form purports to be an acceptance with different terms but contains no "expressly conditional" language. (2) The second form does contain the "expressly conditional" language, but neither party has yet begun to perform. (3) The second form does contain the "expressly conditional" language but the parties have performed. Whose terms get to be controlling in each of those three circumstances?

Review Question 6. What is the problem that the UCC drafters tried to solve by replacing the simple mirror-image rule with the more complex machinations of section 2-207? What are some potential *benefits* (and yes, there are some) to the section 2-207 approach to terms in contract formation?

Review Question 7. "Where a contract is formed" says the *Bayer* court, "by the parties' conduct (as opposed to writings), as is the case here, the terms of the contract are determined exclusively by subsection (3) of § 2-207." What exactly prevented a contract from being formed by the parties' writings in the *Bayer* case? How might those writings have been changed to lead to (as Bayer wanted) formation of a contract under subsections (1) and (2) rather than under subsection (3)?

FLENDER CORPORATION v. TIPPINS INTERNATIONAL, INC.

Superior Court of Pennsylvania
830 A.2d 1279 (Pa. Super. 2003)

JOHNSON, J.

Tippins International, Inc., appeals the trial court's order denying its motion to compel arbitration under the terms of a commercial contract. The trial court determined that the arbitration clause on which Tippins relies was merely a part of its offer of purchase and never became a part of the parties' contract. The court determined, in addition, that the parties formed a contract through course of conduct pursuant to section 2-207(3) of the Pennsylvania [Uniform] Commercial Code that did not include an arbitration provision. [W]e affirm the court's order.

This matter arose out of a "battle of the forms" in which the two contracting parties attempted to impose differing terms on the purchase of goods. Tippins, a Pittsburgh company then engaged in the construction of a steel rolling mill in the Czech Republic, sought to purchase gear drive assemblies from Flender Corporation for installation at the new facility. In January 1998, Tippins mailed a purchase order to Flender specifying terms of sale. The order limited the form in which Flender could acknowledge and accept Tippins's offer and required that the parties' disputes under any resulting contract be submitted to arbitration. The order stated Tippins's terms as follows: "Tippins[s] purchase order is expressly limited to acceptance of 'Standard General Conditions Nova Hut Purchase Order' and special conditions of purchase, which take precedence over any terms and conditions written on the back of the purchase order." The "Standard General Conditions Nova Hut Purchase Order" included the arbitration clause at issue here, requiring that all claims or disputes arising out of the contract must be submitted to arbitration before the International Chamber of Commerce in Vienna, Austria, and would be governed by Austrian law. Moreover, the order limited the form of Flender's acceptance as follows:

AS PART OF THIS OFFER TO PURCHASE GOODS OR SERVICES THE ATTACHED ACKNOWLEDGMENT FORM OF THE PURCHASE ORDER "MUST" BE SIGNED AND RETURNED.... [NEITHER] TIPPINS NOR ANY OF ITS AFFILIATES RECOGNIZES ANY OTHER DOCUMENT AS AN ACKNOWLEDGMENT.

Flender did not sign the attached acknowledgment form or issue any other written acceptance of Tippins's offer, but instead manufactured and shipped the finished drive assemblies. Flender's invoice, which accompanied the drive assemblies, provided "Conditions of Sale and Delivery" that attached conditions to Flender's acceptance of Tippins's order. Flender's conditions provided as follows:

[T]hese terms and conditions will govern all quotations covering purchase orders for and sales of Seller's products and are the sole terms and conditions on which the order of buyer will be accepted. Seller's acceptance of Buyer's order will not constitute an acceptance of printed provisions on Buyer's order form which are

inconsistent with or additional to these terms and conditions unless specifically accepted in writing by the Seller. Buyer's agreement and Buyer's form containing inconsistent or material terms shall not be deemed a specific objection to any terms hereof.

The invoice did not, however, require that Tippins accept these additional terms in order for the parties to form a binding contract.

The invoice also provided a mechanism for dispute resolution. The dispute resolution clause required that "exclusive jurisdiction and venue of any dispute arising out of or with respect to this Agreement or otherwise relating to the commercial relationships of the parties shall be vested in the Federal and/or State Courts located in Chicago, Illinois." Tippins accepted and installed the gear drives but, subsequently, failed to pay the balance due on the shipment. Flender then commenced this action in the Court of Common Pleas of Allegheny County seeking to recover an amount outstanding of \$238,663.15, plus \$76,372.16 in service charges.

In the trial court, Tippins filed preliminary objections to Flender's complaint asserting that the parties' contract of sale required that Flender submit its claim to arbitration in Vienna, Austria. The trial court, the Honorable Ronald W. Folino, denied Tippins's objections, reasoning that the arbitration clause on which Tippins relied had been "knocked out" because it was materially different from the dispute resolution clause in Flender's invoice. The court concluded, in addition, that because both parties proceeded with the transaction as if they had a contract, although neither party had accepted the other's terms, the only contract they could be deemed to have was established by course of conduct under section 2-207(3) of the UCC.

All parties agree that UCC section 2-207 and cases applying it are dispositive of the issue before us. They disagree sharply, however, concerning which subsections apply and whether the difference in provisions governing dispute resolution apparent in the parties' respective forms served to "knock out" both provisions. Accordingly, we shall determine whether the trial court erred in interpreting section 2-207 to conclude that Tippins's arbitration provision was, indeed, "knocked out" and that the contract the parties formed did not compel arbitration.

Where, as here, one party to an agreement seeks to prevent another from proceeding to arbitration, "the trial court's inquiry is limited to determining (1) whether a valid agreement to arbitrate exists between the parties and, if so, (2) whether the dispute involved is within the scope of the arbitration provision." *Midomo Co., Inc. v. Presbyterian Housing Development Co.*, 739 A.2d 180, 188 (Pa. Super. 1999). In this case, the trial court applied the "knockout rule" derived from the Uniform Commercial Code to determine that the parties had not entered a valid agreement to arbitrate because the respective dispute resolution clauses of the parties' forms differed and therefore cancelled one another. The court concluded as

well that the reservations each party attached to acceptance of the offer also cancelled each other and defeated formation of a written contract.

Tippins asserts, contrary to the court's conclusion, that because Flender did not expressly reject the terms of Tippins's purchase order, the parties formed a written contract under section 2-207(1), incorporating the purchase order's terms. Tippins argues that different terms supplied in Flender's invoice were precluded by operation of section 2-207(2) and therefore could not operate to "knock out" its own contrary terms. Tippins concludes accordingly that the parties formed a written contract that incorporated the arbitration clause at issue here.

Tippins's argument poses a novel question in Pennsylvania, as neither our Supreme Court nor we have determined when a written contract may be formed based on differing terms in competing writings, the so-called "battle of the forms." Nor have our courts considered whether, as the trial court concluded, the "knockout rule" is properly applied to cancel conflicting terms in competing writings, thereby creating a contract out of the terms on which the parties actually agree. The text of UCC section 2-207 and decisions of the federal courts predicting adoption of the "knockout" rule in Pennsylvania provide guidance on these questions.

[The court then quotes UCC § 2-207 in its entirety.]

Section 2-207(1) provides that an expression of acceptance may operate to accept an offer even if it contains terms additional to or different from those stated in the offer. Thus, mere non-conformance between competing forms will not undermine the formation of a contract, so long as the parties demonstrate their mutual assent to essential terms. *See Daitom, Inc. v. Pennwalt Corp.*, 741 F.2d 1569, 1576 (10th Cir. 1984). Under such circumstances, a written contract is deemed to exist consisting of the essential terms of the offer, to which the offeree's response has established its agreement. The formation of a written contract is defeated only where the offeree responds with different or additional terms and "explicitly communicate [s] his or her unwillingness to proceed with the transaction" unless the offeror accepts those terms. *See id.* (citing *Dorton v. Collins & Aikman Corp.*, 453 F.2d 1161 (6th Cir.1972)).

In this case, Flender, through its course of conduct and subsequent invoice, accepted the essential terms of Tippins's offer. Although the invoice provided terms that did not appear in Tippins's offer, Flender did not communicate its unwillingness to proceed without them or condition the transaction on Tippins's acceptance of those terms. *See* UCC § 2-207(1). Consequently, we agree with Tippins that the parties did form a written contract under section 2-207(1). However, the content of that contract, beyond essential terms, and whether it includes the arbitration clause on which Tippins relies, remain to be determined.

As noted, Flender, in its invoice, included terms that were either additional to or different from the terms of the offer embodied in Tippins's purchase order. The treatment of additional terms, i.e., those for which no comparable provisions appear

in the offer, is addressed in section 2-207(2). Under that section “additional terms become part of the contract unless: (a) the offer expressly limits acceptance to the terms of the offer; (b) the inserted term materially alters the offer; or (c) notification of objection to the inserted terms has been given or is given within a reasonable time.” *Reilly Foam Corp. v. Rubbermaid Corp.*, 206 F. Supp. 2d 643, 652 (E.D. Pa. 2002). If one of these circumstances occurs, the terms of the offer control and the additional terms will be treated merely as proposals for incorporation into the contract subject to the offeror’s acceptance. *See Daitom*, 741 F.2d at 1578. If, however, none of those circumstances occurs, the offeree’s acceptance controls and the additional terms become part of the parties’ contract. *See id.*

Nevertheless, the fate of different terms, *i.e.*, those for which a comparable provision does appear in the offer, is substantially less clear. Nowhere in its text does § 2-207(2) address them; rather, it confines its discussion to additional terms. Thus, the language of the statute provides little guidance on the question of which set of terms controls when an offeree’s acceptance proposes terms different from those included in the offer. *See Daitom*, 741 F.2d at 1578 (“It is unclear whether different terms in the acceptance are intended to be included under the aegis of additional terms in [§2-207(2)] and, therefore, fail to become part of the agreement if they materially alter the contract.”).

This question of whether different terms are to be treated as additional terms under section 2-207(2) has divided [UCC] scholars White and Summers and prompted courts to adopt competing majority and minority views. In *Reilly Foam*, The Honorable Berle Schiller, formerly a distinguished member of this Court, now a federal trial judge, cogently explained these competing schools of thought:

The minority view permits the terms of the offer to control. Because there is no rational distinction between additional terms and different terms, both are handled under § 2-207(2). For support, advocates of this position point to Official Comment 3: “Whether or not additional or different terms will become part of the agreement depends upon the provisions of subsection [2].” Professor Summers, the leading advocate of the minority rule, reasons that offerors have more reason to expect that the terms of their offer will be enforced than the recipient of an offer can hope that its inserted terms will be effective. The offeree at least had the opportunity to review the offer and object to its contents; if the recipient of an offer objected to a term, it should not have proceeded with the contract.

Reilly Foam, 206 F. Supp. 2d at 653 (internal citations and footnote omitted). This approach treats “different” terms as “additional” terms addressed in section 2-207(2), *see Daitom*, 741 F.2d at 1579, and is the approach advocated by Tippins in this case.

The alternate approach, recognized as preferable by the federal courts in both *Daitom* and *Reilly Foam*, is known as the “knockout” rule, so called because conflicting terms in the offer and acceptance cancel one another, i.e., are “knocked out.” “Different” terms are not treated as “additional” terms for disposition under section 2-207(2), and section 2-207(2) is limited to its express language.

Under this view the offeree’s form is treated only as an acceptance of the terms in the offeror’s form which did not conflict. The ultimate contract, then, includes those non-conflicting terms and any other terms supplied by the U.C.C., including terms incorporated by course of performance (§ 2–208), course of dealing (§ 1–205), usage of trade (§ 1–205), and other “gap fillers” or “off-the-rack” terms (e.g., implied warranty of fitness for particular purpose, § 2–315).

Daitom, 741 F.2d at 1579. In *Reilly Foam*, Judge Schiller explained the pragmatic basis for this approach:

This approach recognizes the fundamental tenet behind UCC § 2-207: to repudiate the “mirror-image” rule of the common law. One should not be able to dictate the terms of the contract merely because one sent the offer. Indeed, the knockout rule recognizes that merchants are frequently willing to proceed with a transaction even though all terms have not been assented to. It would be inequitable to lend greater force to one party’s preferred terms than the other’s. As one court recently explained, “An approach other than the knock-out rule for conflicting terms would result in ... [] any offeror ... [] always prevailing on its terms solely because it sent the first form. That is not a desirable result, particularly when the parties have not negotiated for the challenged clause.” *Richardson v. Union Carbide Indus. Gases, Inc.*, 347 N.J. Super. 524, 790 A.2d 962, 968 (App. Div.2002).

Reilly Foam, 206 F. Supp. 2d at 653–54. Professor White advocates this approach as the most fair and consistent with the purposes of section 2-207. It has now been adopted by a strong majority of U.S. jurisdictions that have considered the issue, and the federal courts have predicted its adoption in others. [The court cites authority suggesting adoption of the “knockout” rule in at least 16 states]. In addition, the United States Court of Appeals for the Tenth Circuit and the United States District Court for the Eastern District of Pennsylvania have both predicted adoption of the “knockout” rule by the Pennsylvania Supreme Court. See *Daitom, Inc.*, 741 F.2d at 1579–80; *Reilly Foam*, 206 F. Supp. 2d at 653–55.

Flender urges us to apply the “knockout” rule in this case. Upon review of the substantial authority, *supra*, supporting application of the “knockout” rule, coupled with the cogent discussions provided by the courts in *Daitom* and *Reilly Foam* predicting its adoption in Pennsylvania, we now join the majority of courts that have considered the issue in declaring that differing terms between a section 2-207 offer

and acceptance are properly subject to the “knockout” rule. This approach finds support . . . in the plain language of section 2-207.

Applying the “knockout” rule espoused in the majority approach to the facts before us, it is apparent that the arbitration clause upon which Tippins relies is not part of the parties’ contract. The dispute provision in Flender’s acceptance, requiring resolution of the parties’ disagreements in state or federal courts in Chicago, is clearly at odds with and quite “different” from the clause in Tippins’s offer requiring arbitration of disputes before the International Chamber of Commerce in Vienna. By operation of the rule we adopt today, those provisions are both, quite clearly, “knocked out.” Neither became a part of the parties’ contract. Accordingly, the trial court did not err in refusing to compel arbitration in response to Tippins’s preliminary objections.

For the foregoing reasons, we affirm the trial court’s order.

Review Question 8. What exactly is the “knockout” rule and when would it apply in a UCC § 2-207 case? Can you describe a UCC § 2-207 offer and acceptance situation where the knockout rule articulated in *Flender* would not apply?

Review Question 9. As the *Flender* opinion clearly shows, different courts have different views on how to treat additional and different terms under UCC § 2-207(2). What is the point of having a *Uniform Commercial Code* if, in fact, the same case facts would reach different results in different states?

Problems

Problem 11.1

Ivy League University’s law school is moving into a new building this summer, and it decided to get rid of some of its old furniture in connection with the move. Mr. Hart, for sentimental reasons, purchased a glass-top wooden coffee table that had previously been housed for many years in the office of his beloved Contracts professor, Kingsfield. Regrettably, the glass top on the table contained invisible hairline stress points, and the first time Mr. Hart placed a mug of hot coffee on the table, the glass explosively shattered. Mr. Hart suffered both first-degree burns from the splattering coffee and serious cuts and bleeding from the shards of glass. He now wants to sue Ivy League University for breach of the implied warranty of merchantability in its sale to him of the coffee table.

(a) Is Ivy League University a “merchant”? Consult UCC § 2-104(1) and its Official Comment 2. Be prepared to argue both sides.

(b) Assume instead that Ivy League University is actually “Ivy League Consignment,” a merchant that regularly sells used furniture, including (the coffee table it acquired from the law school). Did Ivy League Consignment breach the implied warranty of merchantability as to the coffee table it sold to Mr. Hart? Consult UCC § 2-314 and its Official Comments 3 and 4. Be prepared to argue both sides.

Problem 11.2

Reconsider the facts of the 1915 New York case of *Poel v. Brunswick-Balke-Collander Co.*, which you read—and should review again—in Unit 5 of the CONTRACT FORMATION chapter of this casebook.

Assume now that the Uniform Commercial Code (which was not widely adopted until about a half-century after *Poel*) governs the case under its same facts. Would *Poel* come out differently? If so, how and why? Consider UCC § 2-207 in connection with this problem.

Problem 11.3

Computer Manufacturer sent a signed purchase order to Supplier ordering 5,000 Mark-V electronic components for use in building its computers. The purchase order contained several preprinted terms on the back, including (1) a provision that all goods provided by Supplier must be warranted against all defects for five years, and (2) a provision that all disputes under the contract will be settled by arbitration in California. Supplier responds with an acknowledgment form that says, “We have entered your order; please send us shipment details.” Supplier’s form contains preprinted terms on the back which specify (1) all products provided by Supplier carry a limited one-year repair-and-replace warranty, and (2) all disputes under the contract will be settled by arbitration in Florida. Manufacturer subsequently sends a message setting out the delivery schedule, which says “this delivery order is subject to all terms and conditions set forth in our original purchase order.” Nothing further is said. Supplier ships the components. When some of them prove defective after two years, Manufacturer wants to sue Supplier.

Are the components still under warranty? And where (if anywhere) will the dispute be arbitrated? Consider UCC § 2-207 in connection with this problem.

Unit 12: United Nations Convention on Contracts for the International Sale of Goods

ALTERNATIVE REGIMES

Part Three

FOCUS OF THIS UNIT

Commerce is Global, and so are Contracts. Trade between nations has been a major part of world history since at least the time of the Babylonian Empire. But obvious problems arise when transactions cross national borders because laws and commercial practices change. A merchant doing business in another country also has a potential problem in that the courts of one country might tend to favor that country's own citizens in a dispute with merchants from other countries. Even if the courts are completely unbiased, however, there is a more fundamental problem. If the buyer is in the United States and the seller is in Italy and the goods are destined for delivery in Russia, which body of law (U.S., Italian, Russian) will apply? And in which jurisdiction can the suit be brought?

A body of law that goes under the name of conflict of laws¹ historically has tried to deal with these issues by providing rules determining which jurisdiction's law will apply. Also, under an international notion of "comity," courts of one country are supposed to recognize and give effect to judgments from other countries. Still, despite the best efforts of generations of lawyers, judges, and legal scholars, the system relies a great deal on good faith and cooperation, as many more potential ways to evade contract enforcement exist in a multinational setting than do with a domestic contract.

Welcome to the United Nations CISG. To help bring more certainty, many of the world's largest trading nations—and a host of smaller ones—negotiated, signed,

¹ ["Conflict of Laws" is sometimes the subject of its own law school course, and the topic of multiple and conflicting laws otherwise comes up in courses with names like "Private International Law" or "International Business Transactions." Both future commercial litigators and future business transaction lawyers would benefit from a working knowledge of these areas. —Eds.]

and ratified a treaty called the United Nations Convention on Contracts for the International Sale of Goods, or “CISG” in contract-law parlance. Unlike some United Nations pronouncements—the Universal Declaration of Human Rights, for example—the CISG is not an aspirational or advisory document. As you will see from the cases below, it is a multilateral treaty that was signed by the President and ratified by the United States Senate, which makes the treaty the domestic law of the United States. When a contract refers to “the law of Michigan” or “the law of Texas,” that law literally includes the CISG. While American cases involving the CISG most often end up in federal courts, the law would be just as applicable in an American state court.

The CISG is designed to be used as commercial law in a hundred different jurisdictions. Because each of those jurisdictions has its own commercial law—some derived from English common law but most from other sources, especially Roman-derived civil law—the treaty is necessarily a compromise. Some of its rules are similar to those in the United States; some are similar to those in other nations, including those of the European Community. Thus the CISG tracks no single country’s commercial law. This means that a significant population of lawyers tends to dislike the CISG in pretty much every country. (Lawyers tend to prefer law that matches their own local law.) Nevertheless, even for purely American businesses, some aspects of the CISG may be superior for some clients over domestic contract regimes like the UCC. If you wish to be a practicing business lawyer in an era of global commerce, you would be wise to make the CISG as part of your legal toolkit.

When Does the CISG Apply? The CISG applies only to contracts between parties that are residents of “Contracting States,” which is the term used for countries that have ratified the treaty. As of this writing, nearly 80 countries have ratified it, including most of the larger players in international trade. Some notable countries have not ratified the CISG, however, including India, the United Kingdom, much of Southeast Asia, and most of Africa. Importantly for lawyers with clients in North America, the CISG has been ratified by Mexico, Canada, and the United States. Thus, a contract between a business in Laredo, Texas and a business in Nuevo Laredo, Mexico would be governed by the CISG if the contract does not otherwise specify governing law. The CISG’s coverage is also generally limited to business-to-business contracts, so as not to interfere with domestic consumer protection laws.

A very important aspect of the CISG is that parties are free to opt out of it. Thus, an American seller might specify that its transactions will *not* be governed by the CISG, but by the Uniform Commercial Code in a particular state. A German manufacturer might want to specify the law of one of the German states. Unless these parties opt out, however, the CISG applies, because both the United States and Germany are CISG signatories.

Confusing Vocabulary: “State” and “Article.” Right off the bat, the CISG refers to parties in “different States.” In this treaty context, the word “State” does

not mean what it usually means in American law, which is one of the states constituting the United States of America. Rather, a “State” under the CISG is a sovereign *nation*, or perhaps more clearly, a *nation state*. Thus, for purposes of the CISG, the United States is one “State.” Canada, China, and Germany are also each a “State.” But a contract between residents of Oklahoma and Arkansas does not involve “different States” under the CISG.

Fresh off of dealing with Article 2 of the Uniform Commercial Code—a large, chapter-like grouping of statutes—you will probably notice that an “article” of the CISG is not at all the same thing. Indeed, to most American lawyers, what the CISG calls an “article” is more like a “section.” Do not be confused that the term “article” refers to something different in the CISG than it does in the UCC.

Finding the Signatories and Treaty Text. A current list of countries that are CISG signatories can be found at the following link:

<http://www.cisg.law.pace.edu/cisg/countries/cntries.html>.

When working through some of the questions and problems in this unit (or any CISG issue, for that matter), check to see whether or not a jurisdiction is a CISG signatory. For convenience, some relevant provisions of the CISG are provided in the materials below. The full text may be found in a statutory supplement, if your professor has assigned one, or online at the following link:

<http://www.cisg.law.pace.edu/cisg/text/treaty.html>.

Cases and Materials

Treaty Text Note. Articles 1 through 7 of the CISG deal with when the Convention does or does not apply. Read these articles and then answer the review questions that follow.

CISG Article 1

(1) This Convention applies to contracts of sale of goods between parties whose places of business are in different States:

(a) when the States are Contracting States; or

(b) when the rules of private international law lead to the application of the law of a Contracting State.

(2) The fact that the parties have their places of business in different States is to be disregarded whenever this fact does not appear either from the contract or from any dealings between, or from information disclosed by, the parties at any time before or at the conclusion of the contract.

(3) Neither the nationality of the parties nor the civil or commercial character of the parties or of the contract is to be taken into consideration in determining the application of this Convention.

CISG Article 2

This Convention does not apply to sales:

(a) of goods bought for personal, family or household use, unless the seller, at any time before or at the conclusion of the contract, neither knew nor ought to have known that the goods were bought for any such use;

(b) by auction;

(c) on execution or otherwise by authority of law;

(d) of stocks, shares, investment securities, negotiable instruments or money;

(e) of ships, vessels, hovercraft or aircraft;

(f) of electricity.

CISG Article 3

(1) Contracts for the supply of goods to be manufactured or produced are to be considered sales unless the party who orders the goods undertakes to supply a substantial part of the materials necessary for such manufacture or production.

(2) This Convention does not apply to contracts in which the preponderant part of the obligations of the party who furnishes the goods consists in the supply of labour or other services.

CISG Article 4

This Convention governs only the formation of the contract of sale and the rights and obligations of the seller and the buyer arising from such a contract. In particular, except as otherwise expressly provided in this Convention, it is not concerned with:

(a) the validity of the contract or of any of its provisions or of any usage;

(b) the effect which the contract may have on the property in the goods sold.

CISG Article 5

This Convention does not apply to the liability of the seller for death or personal injury caused by the goods to any person.

CISG Article 6

The parties may exclude the application of this Convention or, subject to article 12, derogate from or vary the effect of any of its provisions.

CISG Article 7

(1) In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.

(2) Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.

Review Question 1. Based on CISG Articles 1 through 7, answer whether each of the contracts below would be governed by the CISG. Assume that each contract is silent as to what law governs the contract unless you are told otherwise. For all of these fact patterns, you should determine whether the countries in question are signatories to the CISG.

a. Manufacturer in Mexico contracts to sell 5,000 shirts to a clothing Retailer in Florida, and the contract specifies that it is governed by the law of Mexico.

b. Same facts as the previous problem, except that the contract is silent as to what law will apply.

c. Seller in Japan contracts to sell a custom wall-sized, flat-panel television to Buyer in Hawaii for use in Buyer's home.

d. Same facts as the previous problem, except that Buyer is a museum that will use the flat-panel television for presentation of an upcoming exhibit.

e. Manufacturer in Texas contracts to sell a private jet to Corporation in India who will use the jet for executive business travel, and the contract specifies that it is governed by the “Texas Business and Commerce Code” (which contains the UCC, among other provisions).

f. Same facts as the previous problem, except that the contract is silent as to what law applies.

g. Broker in New York contracts to sell 1,000 shares of a technology stock to Investor in Israel.

h. Construction Contractor in Argentina contracts to build a track-and-field stadium in Brazil.

i. Buyer, a corporate president in Poland, purchases two identical antique desks from Dealer in Vermont. Buyer plans to use one of the desks in her office and the other as a decoration in her living room at home.

j. Buyer in Toronto purchases 10,000 bushels of soybeans from seller in Omaha through an exchange of forms. Buyer’s form specifies the contract will be governed by the Ontario Sale of Goods Act; Seller’s form specifies the Nebraska UCC.

Treaty Text Note. Read Articles 10, 11, 12, and 96 of the CISG, which are excerpted below, before you read the *Asante Technologies* case that follows.

CISG Article 10

For the purposes of this Convention:

(a) if a party has more than one place of business, the place of business is that which has the closest relationship to the contract and its performance, having regard to the circumstances known to or contemplated by the parties at any time before or at the conclusion of the contract;

(b) if a party does not have a place of business, reference is to be made to his habitual residence.

CISG Article 11

A contract of sale need not be concluded in or evidenced by writing and is not subject to any other requirement as to form. It may be proved by any means, including witnesses.

CISG Article 12

Any provision of article 11, article 29 or Part II of this Convention that allows

a contract of sale or its modification or termination by agreement or any offer, acceptance or other indication of intention to be made in any form other than in writing does not apply where any party has his place of business in a Contracting State which has made a declaration under article 96 of this Convention. The parties may not derogate from or vary the effect of this article.

CISG Article 96

A Contracting State whose legislation requires contracts of sale to be concluded in or evidenced by writing may at any time make a declaration in accordance with article 12 that any provision of article 11, article 29, or Part II of this Convention, that allows a contract of sale or its modification or termination by agreement or any offer, acceptance, or other indication of intention to be made in any form other than in writing, does not apply where any party has his place of business in that State.

ASANTE TECHNOLOGIES, INC. v. PMC-SIERRA, INC.

United States District Court for the Northern District of California
164 F. Supp. 2d 1142 (N.D. Cal. 2001)

WARE, U.S.D.J.

This lawsuit arises out of a dispute involving the sale of electronic components. Defendant asserts that Plaintiff's claims for breach of contract and breach of express warranty are governed by the United Nations Convention on Contracts for the International Sale of Goods ("CISG"). Plaintiff disputes jurisdiction and filed this Motion to Remand.

Plaintiff is a Delaware corporation having its primary place of business in Santa Clara County, California. Plaintiff produces network switchers, a type of electronic component used to connect multiple computers to one another and to the Internet. Plaintiff purchases component parts from a number of manufacturers. In particular, Plaintiff purchases application-specific integrated circuits ("ASICs"), which are considered the control center of its network switchers, from Defendant.

Defendant is also a Delaware corporation. Defendant asserts that, at all relevant times, its corporate headquarters, inside sales and marketing office, public relations department, principal warehouse, and most design and engineering functions were located in Burnaby, British Columbia, Canada. Defendant also maintains an office in Portland, Oregon, where many of its engineers are based. Defendant's products are sold in California through Unique Technologies, which is

an authorized distributor of Defendant's products in North America. It is undisputed that Defendant directed Plaintiff to purchase Defendant's products through Unique, and that Defendant honored purchase orders solicited by Unique. Unique is located in California. Determining Defendant's "place of business" with respect to its contract with Plaintiff is critical to the question of whether the Court has jurisdiction in this case.

Plaintiff's Complaint focuses on five purchase orders. Four of the five purchase orders were submitted to Defendant through Unique as directed by Defendant. However, Plaintiff does not dispute that one of the purchase orders, dated January 28, 2000, was sent by fax directly to Defendant in British Columbia, and that Defendant processed the order in British Columbia. Defendant shipped all orders to Plaintiff's headquarters in California. Upon delivery of the goods, Unique sent invoices to Plaintiff, at which time Plaintiff tendered payment to Unique either in California or in Nevada.

The Parties do not identify any single contract embodying the agreement pertaining to the sale. Instead, Plaintiff asserts that acceptance of each of its purchase orders was expressly conditioned upon acceptance by Defendant of Plaintiff's "Terms and Conditions," which were included with each Purchase Order. Paragraph 20 of Plaintiff's Terms and Conditions provides "APPLICABLE LAW. The validity [and] performance of this [purchase] order shall be governed by the laws of the state shown on Buyer's address on this order." The buyer's address as shown on each of the Purchase Orders is in San Jose, California. Alternatively, Defendant suggests that the terms of shipment are governed by a document entitled "PMC-Sierra TERMS AND CONDITIONS OF SALE." Paragraph 19 of Defendant's Terms and conditions provides "APPLICABLE LAW: The contract between the parties is made, governed by, and shall be construed in accordance with the laws of the Province of British Columbia and the laws of Canada applicable therein, which shall be deemed to be the proper law hereof."

Plaintiff's Complaint alleges that Defendant promised in writing that the chips would meet certain technical specifications.

Defendant does not deny that Plaintiff maintained extensive contacts with Defendant's facilities in Portland Oregon during the "development and engineering" of the ASICs. These contacts included daily email and telephone correspondence and frequent in-person collaborations between Plaintiff's engineers and Defendant's engineers in Portland. Plaintiff contends that this litigation concerns the inability of Defendant's engineers in Portland to develop an ASIC meeting the agreed-upon specifications.

Plaintiff now requests this Court to remand this action back to the Superior Court of the County of Santa Clara pursuant to 28 U.S.C. § 1447(c), asserting lack of subject matter jurisdiction. In addition, Plaintiff requests award of attorneys' fees and costs for the expense of bringing this motion.

The Convention on Contracts for the International Sale of Goods (“CISG”) is an international treaty which has been signed and ratified by the United States and Canada, among other countries. The CISG was adopted for the purpose of establishing “substantive provisions of law to govern the formation of international sales contracts and the rights and obligations of the buyer and the seller.” U.S. Ratification of 1980 United Nations CISG: Official English Text, 15 U.S.C. App. at 52 (1997). The CISG applies “to contracts of sale of goods between parties whose places of business are in different States . . . when the States are Contracting States.” Article 10 of the CISG provides that “if a party has more than one place of business, the place of business is that which has the closest relationship to the contract and its performance.”

Defendant asserts that this Court has jurisdiction to hear this case pursuant to 28 U.S.C. § 1331, which dictates that the “district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States.” Specifically, Defendant contends that the contract claims at issue necessarily implicate the CISG, because the contract is between parties having their places of business in two nations which have adopted the CISG treaty.

The CISG only applies when a contract is “between parties whose places of business are in different States.” If this requirement is not satisfied, Defendant cannot claim jurisdiction under the CISG. It is undisputed that Plaintiff’s place of business is Santa Clara County, California, U.S.A. It is further undisputed that during the relevant time period, Defendant’s corporate headquarters, inside sales and marketing office, public relations department, principal warehouse, and most of its design and engineering functions were located in Burnaby, British Columbia, Canada. However, Plaintiff contends that, pursuant to Article 10 of the CISG, Defendant’s “place of business” having the closest relationship to the contract at issue is the United States.

The Complaint asserts *inter alia* two claims for breach of contract and a claim for breach of express warranty based on the failure of the delivered ASICS to conform to the agreed upon technical specifications. In support of these claims, Plaintiff relies on multiple representations allegedly made by Defendant regarding the technical specifications of the ASICS products at issue. Among the representations are: (1) an August 24, 1998 press release; (2) “materials” released by Defendant in September, 1998; (3) “revised materials” released by Defendant in November 1998; (4) “revised materials” released by Defendant in January, 1999; (5) “revised materials” released by Defendant in April, 1999; (6) a September, 1999 statement by Defendant which included revised specifications indicating that its ASICS would comply with 802.1q VLAN specifications; (7) a statement made by Defendant’s President and Chief Executive Officer on October 25, 1999; (8) a communication of December, 1999; and (9) “revised materials” released by Defendant in January, 2000. It appears

undisputed that each of these alleged representations regarding the technical specifications of the product was issued from Defendant's headquarters in British Columbia, Canada.

Rather than challenge the Canadian source of these documents, Plaintiff shifts its emphasis to the purchase orders submitted by Plaintiff to Unique Technologies, a nonexclusive distributor of Defendant's products. Plaintiff asserts that Unique acted in the United States as an agent of Defendant, and that Plaintiff's contacts with Unique establish Defendant's place of business in the U.S. for the purposes of this contract.

Plaintiff has failed to persuade the Court that Unique acted as the agent of Defendant. Plaintiff provides no legal support for this proposition. To the contrary, a distributor of goods for resale is normally not treated as an agent of the manufacturer. Restatement of the Law of Agency 2d § 14J (1957) ("One who receives goods from another for resale to a third person is not thereby the other's agent in the transaction."); *Stansifer v. Chrysler Motors Corp.*, 487 F.2d 59, 64-65 (9th Cir. 1973) (holding that nonexclusive distributor was not agent of manufacturer where distributorship agreement expressly stated "distributor is not an agent"). Plaintiff's dealings with Unique do not establish Defendant's place of business in the United States.

Plaintiff's claims concern breaches of representations made by Defendant from Canada. Moreover, the products in question are manufactured in Canada, and Plaintiff knew that Defendant was Canadian, having sent one purchase order directly to Defendant in Canada by fax. Plaintiff supports its position with the declaration of Anthony Contos, Plaintiff's Vice President of Finance and Administration, who states that Plaintiff's primary contact with Defendant "during the development and engineering of the ASICs at issue . . . was with [Defendant's] facilities in Portland, Oregon." The Court concludes that these contacts are not sufficient to override the fact that most if not all of Defendant's alleged representations regarding the technical specifications of the products emanated from Canada. Moreover, Plaintiff directly corresponded with Defendant at Defendant's Canadian address. Plaintiff relies on all of these alleged representations at length in its Complaint. In contrast, Plaintiff has not identified any specific representation or correspondence emanating from Defendant's Oregon branch. For these reasons, the Court finds that Defendant's place of business that has the closest relationship to the contract and its performance is British Columbia, Canada. Consequently, the contract at issue in this litigation is between parties from two different Contracting States, Canada and the United States. This contract therefore implicates the CISG.

Plaintiff next argues that, even if the Parties are from two nations that have adopted the CISG, the choice of law provisions in the "Terms and Conditions" set forth by both Parties reflect the Parties' intent to "opt out" of application of the treaty. Article 6 of the CISG provides that "the parties may exclude the application of the

Convention or, subject to Article 12, derogate from or vary the effect of any of its provisions.” Defendant asserts that merely choosing the law of a jurisdiction is insufficient to opt out of the CISG, absent express exclusion of the CISG. The Court finds that the particular choice of law provisions in the “Terms and Conditions” of both parties are inadequate to effectuate an opt out of the CISG.

Although selection of a particular choice of law, such as “the California Commercial Code” or the “Uniform Commercial Code” could amount to implied exclusion of the CISG, the choice of law clauses at issue here do not evince a clear intent to opt out of the CISG. For example, Defendant’s choice of applicable law adopts the law of British Columbia, and it is undisputed that the CISG is the law of British Columbia. International Sale of Goods Act ch. 236, 1996 S.B.C. 1 *et seq.* (B.C.). Furthermore, even Plaintiff’s choice of applicable law generally adopts the “laws of” the State of California, and California is bound by the Supremacy Clause to the treaties of the United States. U.S. Const. art. VI, cl. 2. Thus, under general California law, the CISG is applicable to contracts where the contracting parties are from different countries that have adopted the CISG. In the absence of clear language indicating that both contracting parties intended to opt out of the CISG, and in view of Defendant’s Terms and Conditions which would apply the CISG, the Court rejects Plaintiff’s contention that the choice of law provisions preclude the applicability of the CISG.

For the foregoing reasons, Plaintiff’s Motion to Remand is DENIED.

Review Question 2. In *Asante Technologies*, neither party apparently wanted the contract to be governed by the CISG, yet that is what happened. Given all the previous things we have learned about “mutual assent,” does it appear either party “assented” to the CISG’s application? What role should the legal system play in determining matters that contracting parties did not choose for themselves?

Review Question 3. Assume that you represent one of the contracting parties in the *Asante Technologies* case, how would you draft a choice-of-law provision to ensure that the CISG did not apply to the contract? Conversely, is there any way you could add certainty that the CISG would apply, if that would benefit your client? In connection with this last question, be aware that American courts have sometimes been known to ignore the CISG and apply the Uniform Commercial Code if there is a reasonable basis on which to do so. American courts, like American lawyers, are often much more familiar (and comfortable) with the UCC.

Treaty Text Note. Read Articles 18, 19, and 29 of the CISG, which are excerpted below, before you read the *Roser Technologies* case that follows. These articles deal with offer, acceptance, and modification, topics you have previously seen both under the common law and the UCC.

CISG Article 18

(1) A statement made by or other conduct of the offeree indicating assent to an offer is an acceptance. Silence or inactivity does not in itself amount to acceptance.

(2) An acceptance of an offer becomes effective at the moment the indication of assent reaches the offeror. An acceptance is not effective if the indication of assent does not reach the offeror within the time he has fixed or, if no time is fixed, within a reasonable time, due account being taken of the circumstances of the transaction, including the rapidity of the means of communication employed by the offeror. An oral offer must be accepted immediately unless the circumstances indicate otherwise.

(3) However, if, by virtue of the offer or as a result of practices which the parties have established between themselves or of usage, the offeree may indicate assent by performing an act, such as one relating to the dispatch of the goods or payment of the price, without notice to the offeror, the acceptance is effective at the moment the act is performed, provided that the act is performed within the period of time laid down in the preceding paragraph.

CISG Article 19

(1) A reply to an offer which purports to be an acceptance but contains additions, limitations or other modifications is a rejection of the offer and constitutes a counter-offer.

(2) However, a reply to an offer which purports to be an acceptance but contains additional or different terms which do not materially alter the terms of the offer constitutes an acceptance, unless the offeror, without undue delay, objects orally to the discrepancy or dispatches a notice to that effect. If he does not so object, the terms of the contract are the terms of the offer with the modifications contained in the acceptance.

(3) Additional or different terms relating, among other things, to the price, payment, quality and quantity of the goods, place and time of delivery, extent of one party's liability to the other or the settlement of disputes are considered to alter the terms of the offer materially.

CISG Article 29

(1) A contract may be modified or terminated by the mere agreement of the parties.

(2) A contract in writing which contains a provision requiring any modification or termination by agreement to be in writing may not be otherwise modified or terminated by agreement. However, a party may be precluded by his conduct from asserting such a provision to the extent that the other party has relied on that conduct.

ROSER TECHNOLOGIES, INC., v. CARL SCHREIBER GmbH

U.S. District Court for the Western District of Pennsylvania
2013 U.S. Dist. LEXIS 129242 (Sept. 10, 2013)

ARTHUR J. SCHWAB, U.S.D.J.

[CSN Metals (“CSN”) sent quotations to Roser Technologies, Inc. (“RTI”) for the manufacture of copper plates. RTI responded with purchase orders that referred to the CSN quotations. CSN then sent order confirmations to RTI which referenced RTI’s purchase orders. These confirmations included a new provision, not included in the original quotes or purchase orders, which allowed CSN to ask for “guarantees or payment in advance” in some situations. When CSN subsequently insisted on invoking the payment term, and refused to deliver without it. RTI refused to comply and subsequently bought its requirements elsewhere. RTI sued. CSN counterclaimed. The key question before the court was whether a contract had been formed and whether it included the payment term. The answer, said the court, depended on what law applied to the transaction.]

The parties agree that the choice is between the Uniform Commercial Code (“UCC”), and the United Nations Convention for the International Sale of Goods (“CISG”).

RTI argues that there is no choice-of-law issue because the UCC and CISG do not differ with respect to the issue before the Court. CSN argues that there is a difference and that the CISG applies.

[Under the CISG], additional terms are governed by Article 19.

Few American courts, either state or federal, have interpreted Article 19. The United States District Court for the Southern District of Ohio has stated that “the CISG applies the common law concept of mirror image.” *Miami Valley Paper, LLC v.*

Lebbing Eng'g & Consulting GmbH, 2009 U.S. Dist. LEXIS 25201, 2009 WL 818618, *4 (S.D. Ohio Mar. 26, 2009); see also *CSS Antenna, Inc. v. Amphenol-Tuchel Elecs., GmbH*, 764 F. Supp. 2d 745, 752-53 (D. Md. 2011) (applying Article 19 in a fashion consistent with the mirror image rule).

[The court noted that German court decisions regarding the CISG hold that a new term sent in response to a standard form is a “counteroffer,” and that commentators on the law agree that “the CISG in fact adopts the old common law ‘Mirror Image Rule.’”]

Thus, with respect to the battle of the forms, the determinative factor under the CISG is when the contract was formed. The terms of the contract are those embodied in the last offer (or counteroffer) made prior to a contract being formed. Once the contents of the original contract are determined, both parties must affirmatively assent to any amendment to the terms of the contract for such amendment to become part of the contract. See *Chateau des Charmes Wines Ltd. v. Sabate USA Inc.*, 328 F.3d 528, 531 (9th Cir. 2003).

“[N]o provision of the [CISG] creates such diametrical opposition to the [UCC] rule as does Article 19 in its clear adoption of the ‘mirror image’ rule.” 1 RONALD A. BRAND, *FUNDAMENTALS OF INTERNATIONAL BUSINESS TRANSACTIONS* 75 (2013). Under the UCC, standard conditions in an acceptance that materially alter the terms of the agreement are disregarded. Under the CISG, an acceptance with different standard conditions is not actually an acceptance, but rather is a rejection and counteroffer.

The CISG “applies to contracts of sale of goods between parties whose places of business are in different States . . . when the States are Contracting States.” *Forestal Guarani S.A. v. Daros Int’l, Inc.*, 613 F.3d 395, 397 (3d Cir. 2010) (quoting CISG Article 1(1)(a)). The United States ratified the CISG on December 11, 1986. Germany is also a contracting state to the CISG. See *It’s Intoxicating, Inc. v. Maritim Hotelgesellschaft mbH*, 2013 U.S. Dist. LEXIS 107149, 2013 WL 3973975, *17 (M.D. Pa. July 31, 2013). The parties’ places of business were in different states, as is required by Article 1(2) of the CISG.

“Because both the United States [and Germany] are signatories to the CISG and the alleged contract at issue involves the sale of goods . . . the CISG governs.” *Forestal Guarani*, 613 F.3d at 397. However, just because the CISG governs does not necessarily mean that it applies in this case. Under Article 6 of the CISG, the parties may choose to exclude application of the CISG. In order for the contract to exclude the CISG it must include language which affirmatively states that the CISG does not apply. *BP Oil Int’l, Ltd., v. Empresa Estatal Petroleos de Ecuador*, 332 F.3d 333, 337 (5th Cir. 2003).

Having determined that the CISG is the applicable law, the Court turns to the formation of a contract between RTI and CSN. CSN argues that RTI’s purchase orders were offers and that CSN’s order confirmations were rejections and

counteroffers under the CISG. RTI, on the other hand, argues that its purchase orders were offers and that CSN's order confirmations were in fact acceptances of the offers.

[CSN's] order confirmations stated that, "If we have offered a payment target, a sufficient coverage by our credit insurance company is assumed. In case this cannot [be] obtained we have to ask for equivalent guarantees or payment in advance."

[This language] was in regular print on the front of both order confirmations. The language did not reference any other document but rather was an independent additional term under Article 19 of the CISG. Furthermore, the additional term was material under CISG Article 19(3), as it related to payment terms for the goods.

RTI's sole argument against this additional term under the CISG is that the additional term did not impose any duty on RTI but merely gave CSN the ability to ask for equivalent guarantees or advance payment. This argument is without merit. The word "ask" can mean "to expect or demand." AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE (4TH ED. 2000). When considered in the context that it was used, this is the natural meaning of the word "ask" in the order confirmations. The same sentence that the word "ask" appears in also uses the term "guarantees," evidencing the mandatory nature of the term ask. Furthermore, it is illogical to include in a contract a provision by which one party would request another party provide something as important as a guarantee regarding payment and then be fully satisfied if the other party refused to provide such a guarantee or advance payment. Any reasonable businessperson reading such a statement would have recognized that this term was a requirement if CSN did not obtain sufficient coverage from its insurance carrier.

The additional term that was properly incorporated into CSN's order confirmations was material under Article 19. Thus, the order confirmations were not in fact acceptances but rather constituted counteroffers.

The final step in determining if a contract was formed between RTI and CSN is consideration of the emails that were exchanged between the parties in August 2011. CSN argues that these emails were acceptances by RTI and therefore a valid contract was formed between the parties. [The court reviews the emails, including one in which RTI noted that it had received the order confirmations and that CSN should "please proceed with the manufacture of these plates."]

Article 18(1) of the CISG provides that "A statement made by or other conduct of the offeree indicating assent to an offer is an acceptance." RTI's acceptance of CSN's counteroffer with respect to purchase order 6761 is evident from the email exchange.

Having determined the parties obligations under the contract, the Court now turns to whether either party breached its obligations under the contract. CSN argues that RTI repudiated the contract and therefore was in material breach. Article 71 of the CISG provides that: "A party may suspend the performance of his obligations if,

after the conclusion of the contract, it becomes apparent that the other party will not perform a substantial part of his obligations as a result of . . . his conduct in preparing to perform or in performing the contract.” In this case, there is no dispute that RTI refused to perform on the contract. RTI sent a letter to CSN on October 24, 2011, stating that it would procure the requested copper from an alternate supplier. CSN responded stating, “please be informed the cancellation is NOT ACCEPTED by CSN.” RTI then sent a follow-up letter to CSN on October 28, 2011, stating that it would not follow through with its obligations relating to advance payment or other forms of guarantee. On November 4, 2011, RTI sent yet another letter confirming it was canceling the purchase orders.

It is hard to imagine a clearer repudiation. RTI sent repeated notices to CSN over an 11 day period setting forth its reasons for not performing the contract. In short, RTI believed that the terms of the contract were different than they actually were. Thus, RTI breached its contractual obligations to CSN.

Review Question 4. The CISG, says the court, adopts the “mirror image” rule, which in the “battle of the forms” situation is the equivalent of the “last shot” rule—whoever sends the last form wins. Under the UCC’s rules of acceptance in section 2-207, would the case have come out differently? If so, you should be prepared to explain how. If CSN’s payment clause had not become part of the contract, wouldn’t that mean that the UCC is a “first shot” rule—that whoever sends the first form wins? Which rule makes more sense and why?

Problems

Problem 12.1

Bulldog Motors PLC is a British corporation that manufactures high-end motorcycles. Its principal place of business is Leeds, United Kingdom. It has a wholly owned subsidiary, Bulldog North America, Inc. (“BNA”), a Delaware corporation with its principal place of business in Huntsville, Alabama, where it operates an assembly plant for motorcycles to be sold in the United States, Canada, and Mexico. Mei Guo Products Ltd. (MGP) is a Swiss corporation with its principal place of business in Singapore. It operates a wholly owned subsidiary, MGP-Thailand Corp. (MGPT), which is a Swiss corporation with its principal place of business and its manufacturing facilities for automotive parts in Bangkok, Thailand.

On June 1, the purchasing manager for BNA, who is in Toronto, Canada, for a regional corporate meeting, does a video conference call with the sales manager of

MGPT, who is in Bangkok. The purchasing manager and the sales manager agree orally that BNA will purchase 10,000 flex rotor assemblies from MGPT at a price of £27.50 per unit, including shipping from Thailand to Los Angeles, California, or a total contract price of £275,000 (roughly US\$300,000 at the time of the transaction). The transaction is subsequently confirmed in writing. Subsequently, a dispute arises between the parties. MGPT refuses to ship the items, and BNA claims breach of contract. What law applies to the transaction? Might there be something you have to look up in connection with answering this question—something we discussed at the beginning of this unit?

Problem 12.2

Stuart is a successful lawyer who owns his own litigation firm in Detroit, Michigan. He is a huge sports fan and firm's offices are decorated with sports memorabilia. While at an online auction site, eBay, he sees a "Buy it Now" offer for three framed, autographed hockey jerseys from Specialty Sports Ltd., a sports memorabilia retailer in Windsor, Ontario, Canada. The jerseys are of three famous players who all wore number 9: Gordie Howe (Detroit Red Wings), Maurice "Rocket" Richard (Montreal Canadiens), and Bobby Hull (Chicago Blackhawks). The price listed is CAD3,000 (or about US\$2,250 at the time of the offer). Stuart clicks on the "Buy it Now" button and pays with his law firm credit card. He plans to feature the framed jerseys in the waiting room in his law firm. Specialty Sports delivers the jerseys to Stuart's office address. If a dispute develops, what law applies to the transaction?

Problem 12.3

LiveAction Toys, Inc. is a U.S. toy manufacturer with its main offices in White Plains, New York. LiveAction does not do its own manufacturing, but rather buys most of its products from China and Southeast Asia. At a trade show in London, England, LiveAction's representatives enter into negotiations with Ausgezeichnete Spielzeug GmbH ("ASG"), a German toy importer-distributor based in Worms, Rheinland-Pfalz, for import of comic book action figures into the European Union. There are extensive discussions of prices, delivery dates, promotional assistance, and other terms.

A week after the trade show, ASG sends a Purchase Order to LiveAction, which orders 100,000 action figures, at a total price of "US\$326,000 Delivered at Place—Worms." The ASG purchase order contains clauses which provide that the transaction "will be governed by the laws of the Federal Republic of Germany," and that "all disputes shall be settled by binding arbitration under the rules of the International Chamber of Commerce in Frankfurt, Germany." LiveAction responds with an Order Confirmation that restates all of the relevant terms, but provides that the transaction

“will be governed by the New York Uniform Commercial Code,” and that “all disputes shall be settled by binding arbitration under the rules of the American Arbitration Association in New York City.” Nothing further is sent.

LiveAction delivers the toys, accompanied by a shipping document that reiterates the terms in the Order Confirmation. A dispute subsequently develops when ASG claims that many of the toys are defective and refuses to pay. LiveAction sues in New York district court. ASG moves to compel LiveAction to arbitrate under ICC rules in Mainz. Should the court compel arbitration? If so, where? And what law will apply to the dispute?



AMERICAN CONTRACT LAW FOR A GLOBAL AGE

Chapter V: Contract Defenses

Unit 13: Capacity to Contract

Unit 14: The Statute of Frauds

Unit 15: Assent-Based Defenses

Unit 16: Policy-Based Defenses

An Introduction to CONTRACT DEFENSES

Where Are We Now? At this point, you have marched through the book far enough to understand the concepts of formation and consideration. Pretend now that a contract problem walks into your law office. You plainly find an exchange of consideration. You plainly have an offer and an acceptance by the appropriate parties. Under the section we called “Formation,” has a contract been formed? At this point you might be tempted to think that the answer is yes, but you probably are familiar enough with the way law school works that the answer is likely to be “maybe.” At this point, we fairly can say there is a *presumption* that a contract has been formed, but that the presumption can be rebutted.

Assume, for example, that *A* and *B*—anonymous parties for the moment—sign a written agreement under which *A* agrees to sell *B* her car for \$5,000. We have a signed agreement, so basic formation issues are not a problem. Also, both cash and automobiles are things of value that can act as consideration. To decide if a contract actually was formed, nonetheless, we may have to answer some other questions. Would it matter, for example, if *A* was unwilling and *B* held a gun to her head to make her sign the agreement? Would it matter that *B* was only six years old? Or that *A* purportedly sold the car while knowing that it had actually been destroyed by a meteor earlier that morning and was a smoking hunk of melted metal at the time of the sale?

Enter the Defenses. Your intuition may be that courts would not enforce agreements in the above situations. But what are the reasons why not? As a matter of policy, we do not want contract law to reward liars and thugs or to allow children potentially to be exploited. For reasons such as these, contract law includes the concept of *defenses to formation*. If a valid defense exists, no enforceable agreement exists even though the rules of formation and consideration suggest otherwise. In earlier times, lawyers generally would call these situations “unenforceable contracts.” Today, since the definition of contract includes enforceability, an unenforceable contract is a bit of an oxymoron, so some prefer to say that there is no contract at all. The terminology may vary, but the effect, no matter what we call it, is that the party claiming breach cannot recover.

Shifting Burdens of Proof. In contract litigation, the burden of the party claiming the breach (usually the plaintiff) is to prove the existence of an agreement and of consideration, where such matters are disputed issues. At that point, the burden shifts to the alleged breaching party to raise any of the various defenses to formation. That party will bear the burden of proof on that issue. The plaintiff does not have to prove he did not brandish a gun; the defendant must prove he did. For those litigating contract disputes, the burden of proof can be significant.

The units that follow explore various defenses that are commonly raised in contract litigation: lack of capacity, the statute of frauds, defenses based on lack of assent, and public-policy defenses.

Unit 13: Capacity to Contract

CONTRACT DEFENSES Part One

FOCUS OF THIS UNIT

You may recall from the introduction to the course that one of the requirements of a valid contract is “competent parties.” A competent party, in legal parlance, is one who has *capacity* to contract. The contracts of competent parties are valid, those of incompetent parties are voidable—that is, they can be undone at the request of the incompetent party (or, in some cases, that party’s representative). The capacity requirement is the subject of this unit.

Voluntary and Involuntary Obligation. In general, tort law and criminal law *involuntarily* impose legal duties on the persons subject to those laws. As an individual member of society you do not, for instance, have the right to commit a battery or rob a bank. Contract law, in contrast, usually involves taking on legal duties that would not exist but for the *voluntary* entry into a contractual relationship. A person has more legal obligations after entering into a contract than she has before doing so. Is the ability to take on new duties, incur potential liability, and to limit one’s future legally really a valuable power? Perhaps counterintuitively (as least when we frame the question that way), the answer is an emphatic *yes*. The ability of parties to legally bind themselves has far-reaching economic and social consequences. If you cannot legally bind yourself to repay a loan, for example, no one is going to give you one, which means your future options (getting a car or a home or starting a business) are limited. Similarly, the *inability* to enter into enforceable agreements also has economic and social consequences—largely negative ones, as history demonstrates.

The Consequential Power to Contract. In many societies in history, the power to contract has often been limited to a narrow class of people who use it to help consolidate their political power. In early Rome, for example, only the head of a family, known as the *paterfamilias*, had the power to make binding contracts. This arrangement allowed the heads of the families to maintain their power and authority,

which extended even to being able to sell or purchase family members (in a society where debt-slavery was a widespread practice). In more recent eras, limiting the rights of citizens to contract has been a feature of communist societies whose goal was to keep people from accumulating money and (as a result) power. Historically, the question whether particular classes of persons should be free to enter into contracts has been a matter of profound political importance. The ability to enter into contracts, and to have those contracts impartially enforced by state authorities, means the ability to make money—and accumulating wealth has always been a good way to increase one’s political power.

Capacity as an Oppressive Doctrine. Sadly, from the earliest history of the common-law system until relatively recent times, the doctrine of capacity has been used to exclude whole classes of persons from the ability to enter into legally binding agreements. This exclusionary role was sometimes been justified by an explicit intent to restrict certain people from the means to obtain power. Medieval European Jews often were denied legal capacity to contract, for instance. Other justifications for denying contractual capacity centered around the necessity to “protect” various groups from their supposed “natural” inability to compete on equal terms. Nineteenth century American cases are full of statements that, for example, women and African-Americans should not be permitted to enter contracts because they would simply be taken advantage of by “superior” white males.¹ Not surprisingly, people legally protected in such a way have disputed the need for such protection. Gaining freedom to contract was accordingly an important goal of early civil rights movements. Married (and white) women in the United States only acquired the legal right to control their own property and enter into contracts without their husbands’ permission with the passage of Married Women’s Property Acts, beginning in 1848. African-Americans theoretically gained the right to contract with the adoption of the 14th Amendment to the United States Constitution in 1868. Still, neither women nor African-Americans obtained full power to contract until well into the 20th century in many instances, as vestigial rules, special legislation, and “Jim Crow” laws restricted access to economic power that arises from the ability to contract.

Capacity Today. Despite this history of abuses of the concept of capacity, you should know that many of its uses are well-intentioned. Today, certain rules of contract law take into account special categories of people (*e.g.*, consumers and employees) and restrict their ability to freely contract as to certain terms. By far, however, the two most important categories of what the law calls “incapacity to contract” are (1) minors, and (2) persons who are suffering from serious mental

¹ [In one infamous Georgia case, *Bryan v. Walton*, 14 Ga. 185 (1853), the court held that a free black slave owner was incompetent to sell the slaves he owned (which he had received by inheritance), and that it was counterproductive to give him the right to contract because such freedom simply is “impossible for him to exercise wisely for himself.” As a result, he could only be permitted to enter into contracts if a white “guardian” who was appointed for him approved.—Eds.]

disabilities. Yet even these categories are not without controversy. Minors, after all, play an increasingly important economic role in society, and enter into a vast number of contracts every year. Moreover, the question of exactly who is too “mentally disabled” to be allowed to contract is the subject of some dispute, as well. America, after all, traditionally lets eccentric people make their own choices regardless of the opinions of society at large. Drawing the line between “eccentric” and “unable to act in a reasonable manner” can sometimes be difficult.

In connection with these materials, you may find it helpful to review Restatement (Second) of Contracts §§ 12-16.

Cases and Materials

EX PARTE ODEM

Supreme Court of Alabama
537 So.2d 919 (Ala. 1988)

SHORES, J.

We granted this petition for writ of certiorari in order to review the limited issue of whether a minor who executes a contract for a “necessary” is obligated to comply with the express terms of the entire contract, including those provisions regarding attorney fees and waiver of personal exemptions.

[Iris Odem’s nineteen-day-old son was admitted to Children's Hospital of Birmingham due to a serious illness. On the date of admission, March 15, 1985, Odem completed and signed an inpatient registration form, whereby she agreed to be responsible for all charges incurred in the hospital for the medical treatment rendered to her child. The contract provided that in the event she failed to pay and the hospital had to sue to collect, Odem would be liable for attorneys’ fees. As of that date, Odem was seventeen, and thus a minor under Alabama law. Odem did not pay the charges, which totaled more than \$5,000. The hospital sued. During the pendency of the suit, Odem turned eighteen and shortly thereafter disaffirmed the contract with the hospital. The trial court ordered summary judgment for the hospital.]

We agree that medical services provided to an infant child of a minor are “necessaries” for which the minor parent may be obligated to pay, but we hold that the attorney fees for enforcing the contract are not “necessaries” for which the minor is legally obligated to pay.

The general rule of law is that contracts of minors are voidable. That is, the contract may be avoided or ratified at the election of the minor. *Flexner & Lichten v.*

Dickerson, 72 Ala. 318 (1882). In the instant case, Iris Odem disaffirmed, or avoided, the contract she had executed with Children's Hospital. Consequently, Iris Odem's obligation to pay for necessities, *i.e.*, the medical services rendered to her infant son, is not the result of the express contract between the parties, but arises from a quasi-contractual relationship created by operation of law which enforces the implied contract to pay. 43 C.J.S. *Infants* § 180 (1978). Therefore, a minor is not liable on any portion of the contract, or for what was agreed to be paid, except that the minor is liable for the just value of the necessities.

In *Wiggins Estate Co. v. Jeffery*, 19 So. 2d 769 (Ala. 1944), this Court, with approval, quoted the following:

It is for the court to determine, as a matter of law, in the first place, whether the things supplied may fall within the general classes of necessities, and if so, whether there is sufficient evidence to warrant the jury in finding that they are necessary. If either of these preliminary inquiries be decided in the negative, it is the duty of the court to nonsuit the plaintiff who seeks to recover from the [minor]. If they be decided in the affirmative, it is then for the jury to determine whether, under all the circumstances, the things furnished were actually necessary to the position and condition of the [minor], as well as their reasonable value, and whether the [minor] was already sufficiently supplied

Therefore, the class and character of articles that are necessities are issues of law.

Do the attorney fees in this case fall within the general classes of necessities? Stated differently, are the attorney fees necessary to the position and condition of the minor?

Under Alabama law, attorney fees are recoverable from an opposing party only when provided for by contract or by statute. Thus, any contractual provision regarding the recovery of attorney fees in this case is for the benefit of Children's Hospital, because the attorney fees would not otherwise be recoverable. Accordingly, attorney fees are not necessary to the position and condition of the minor and are not recoverable from Iris Odem. It is the policy of the law to protect infants against their own mistakes or improvidence, and from designs of others, and to discourage adults from contracting with an infant. 43 C.J.S. *Infants* § 180 (1978).

Accordingly, when an infant executes a contract, the infant is liable only on his implied promise to pay for necessities, and all other provisions of the contract are voidable at the election of the infant. Further, attorney fees are not necessities, because they are not necessary for the position and condition of the infant. We reverse the judgment of the Court of Civil Appeals to the extent that it holds that Iris Odem is obligated under all of the terms of the contract, and we affirm that portion of the

judgment that holds that she is obligated for the reasonable value of the medical services rendered to her infant son.

Review Question 1. The *Odem* decision uses the word “voidable” to describe a contract. What exactly does that mean and what are the consequences for entering into a voidable contract? How is “voidable” different than “void”? Consult section 7 of the Restatement (Second) of Contracts (and a legal dictionary) in answering this question. By the way, what exactly are “necessaries” and what is the rationale for holding minors liable for them when they would not be liable for other purchases?

Secondary Sources

Introductory Note. The basic analysis in infancy cases is: (1) contracts of minors are voidable; (2) if the minor disaffirms the contract, the minor is not liable under it; but (3) where a minor has received “necessaries” under a contract, the minor will be required to pay for the reasonable value of what was provided. While the rules are simple in theory, they have some twists and turns in actual practice. The selections below summarize some of the capacity complexities of which you should be aware.

W. E. Shipley, *Infant’s liability for use or depreciation of subject matter, in action to recover purchase price upon his disaffirmance of contract to purchase goods*, 12 A.L.R.3d 1174:

Where a minor disaffirming a contract for the purchase of goods seeks to recover payments that he has made, and the seller claims the right of recouping the amount by which the goods in question have depreciated while in the minor’s possession, or the value of their use during that period, the courts are faced with a troublesome choice between conflicting policies: (1) that of protecting the minor against his own improvidence and the impositions of more mature and worldly adults, by permitting the minor to freely avoid his contracts not for necessities, and (2) that of doing equity to the normally innocent businessman who may otherwise be taxed severely for the infant’s benefit.

Faced with such a choice, some courts have adopted the clear line of rigidly enforcing the infant’s right of avoidance, holding that his obligation is at most to return such of the property purchased as remains in his hands at the time of disaffirmance, in the condition in which it then is, and that the seller must bear any

loss from the transaction, including the depreciation of the goods in question and the value of their use while in the infant's possession.

Other courts have gone to the opposite extreme and have conditioned the right to disaffirmance upon the restoration of the innocent seller to status quo, holding that in a proper case the infant's recovery must be diminished by the amount that the property has depreciated while in his possession or (and?) the value of its use during that period.²

The courts or legislatures in other jurisdictions have, however, rejected both these extreme views and have taken the position that depreciation or use may be deducted from the minor's recovery under some circumstances but not others.

A. D. Kaufman, *Infant's misrepresentation as to his age as estopping him from disaffirming his voidable transaction*, 29 A.L.R.3d 1270:

The policy of the law to protect infants by permitting them to disaffirm contracts into which they have entered, frequently seems to operate inequitably as to the other contracting party who, having acted in all innocence, may be compelled to bear the burden of his contract without being assured of any of its benefits. These inequities are especially apparent in the situation where the other party contracted, not only without knowledge of the infancy of his opposite number, but in reliance on affirmative representations by the infant that he was in fact of proper age to contract.

Faced with the dilemma of choosing between the policy of protecting infants and that of not rewarding fraud, some courts have chosen to give overriding effect to the rule that an infant cannot be bound by his contract and have held that notwithstanding the fact that the contract may have been induced by the infant's fraudulent misrepresentation of his age, it cannot be enforced against him, either at law or in equity. Indeed, these courts have frequently gone further and held that the infant, notwithstanding his fraud, may seek affirmative relief by suing at law to recover such consideration as he may have paid, or by seeking a variety of equitable remedies.

² [In the "rigidly enforcing the "right of avoidance" category, the author places Alabama, Arkansas, Idaho, Illinois, Indiana, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, New Hampshire, North Carolina, Ohio, Pennsylvania, Texas, Utah, Vermont, Washington, and Wisconsin. In the "restoration of the innocent seller to the status quo" category, he lists Alabama, Arkansas, California, Colorado, Connecticut, District of Columbia, Illinois, Minnesota, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oregon, South Dakota, New Hampshire, Tennessee, and Texas. Note that several states (Alabama, Arkansas, Illinois, Minnesota, New Hampshire, and Ohio) manage to appear on *both* lists. These lists should give you some idea that the rules vary widely, and even the rules within a single state are occasionally confusing and difficult to ascertain.—Eds.]

This seemingly harsh result has usually been justified, theoretically, on the ground that an infant without legal capacity to contract cannot be held to have capacity to obtain the same result by his representations as to his age, and practically, on the ground that to permit the other contracting party to obtain or retain benefits under the contract on the ground of estoppel would be to emasculate the underlying policy of protecting infants.

Other courts, more tender toward the defrauded party, have held that a fraudulent misrepresentation of age by an infant may estop him to disaffirm the contract. This result has been reached more readily where the infant was seeking affirmative relief, in a legal or equitable action to recover the consideration paid. The courts finding an estoppel in such cases frequently advert to Lord Mansfield's dictum that the defense of equity should be a shield and not a sword, or to such equitable maxims as that he who seeks equity must do equity or that one coming into equity must come with clean hands.

Even where the infant has been made a defendant in an action on the contract, estoppel has frequently been applied against him, in actions at law, but more especially in equity.

Statutes in a few jurisdictions have codified the rule that an infant may be precluded from disaffirming where his fraudulent misrepresentations as to age induced the contract.

Cheryl B. Preston & Brandon T. Crowther, *Infancy Doctrine Inquiries*, 52 SANTA CLARA L. REV. 47 (2012):

A minor is liable on a contract for necessities. Society wants to allow minors to obtain items necessary for their survival where the minor has no other means to do so. We therefore encourage adults to enter such contracts by assuring merchants that minors' contracts for necessities will be binding. Applicability of this exception is based on the need of the infant at the time of contracting, rather than on the nature of the item contracted for. This approach limits the exception dramatically, and puts the burden on merchants to make a judgment whether an item is a necessity for a particular minor. Although society requires such an exception, the law limits its scope. Thus, if a minor contracts for what would generally be a necessity, but that minor has already been provided for by his parents or his parents are willing to provide for him, the contract is not binding and the minor is permitted to disaffirm it. Further, even when validly contracting for necessities, the minor is never held liable for more than the actual value of the necessities. And finally, a minor is not bound to an executory contract to pay for necessities—only for the portion that has been received.

Deciding what a necessity is has been characterized by at least one court as a two-step inquiry. First, the court must determine, as a matter of law, “whether the subject of the contract is generally considered a necessity.” This is still a nebulous

inquiry beyond the obvious categories such as food and clothing that are easily within this definition. Whether other areas, such as transportation and communication devices, can be considered one of these categories is a more difficult inquiry. Second, if the subject of the contract can be a necessity, the fact-finder must determine whether it actually was a necessity to that specific minor.

Determining what is a necessity for a minor is a fact-intensive inquiry, although also a matter of law, and it is useful to look at what has been upheld and rejected as a necessity in the past. Food, clothing, shelter, and medical expenses are in the traditional category of necessities. Education also generally falls in this list. Interestingly enough, “retaining counsel in criminal proceedings” has also been upheld as a necessity and “under extraordinary circumstances,” counsel in a civil suit can be as well.

The question of transportation is an interesting inquiry. Can transportation ever constitute a necessity for an unemancipated minor? In *Bowling v. Sperry*, [184 N.E.2d 901 (Ind. Ct. App. 1962)], the court seemed to answer that question in the affirmative. Although the court claimed that the car purchased by a teenager in that case was not a necessity, the court commented that “every high school boy today wants a car of his own, and many of them own automobiles which under given circumstances may be considered necessities.” However, according to *Bowling*, a car must be “vital to [the minor's] existence” to rise to such a level. *Star Chevrolet Co. v. Green*, [473 So. 2d 157, 161 (Miss. 1985)], a more recent case, held that a car was not a necessity for the minor. While that court seemed wary of ever allowing a car to be a necessity, the fact that the minor had a car pool available for transportation also factored prominently in the court's analysis. Of course, a second car would not qualify as a necessity.

Overall, the necessities exception to the infancy doctrine provides a consistent and useful check on the infancy doctrine. It is unlikely to bind minors to very many contracts, but serves as a way for minors to obtain essential goods and services without requiring adults to take extra risks in providing them.

Review Question 2. Certain other contracts made by minors are routinely enforceable, including contracts to join the military, contracts to repay student loans and contracts to provide support for the promisor’s children. Why the difference in treatment? Consider the rationale for treating certain contracts differently as you read the following excerpt from the Credit CARD Act, passed by Congress and signed by the President in 2009.

CREDIT CARD ACCOUNTABILITY RESPONSIBILITY AND DISCLOSURE ACT OF 2009

15 U.S.C. § 1637(c)(8) Applications from underage consumers.

(A) **Prohibition on issuance.** No credit card may be issued to, or open end consumer credit plan established by or on behalf of, a consumer who has not attained the age of 21, unless the consumer has submitted a written application to the card issuer that meets the requirements of subparagraph (B).

(B) **Application requirements.** An application to open a credit card account by a consumer who has not attained the age of 21 as of the date of submission of the application shall require—

(i) the signature of a cosigner, including the parent, legal guardian, spouse, or any other individual who has attained the age of 21 having a means to repay debts incurred by the consumer in connection with the account, indicating joint liability for debts incurred by the consumer in connection with the account before the consumer has attained the age of 21; or

(ii) submission by the consumer of financial information, including through an application, indicating an independent means of repaying any obligation arising from the proposed extension of credit in connection with the account.

Review Question 3. Prior to 2009, college students between 18 and 21 could get credit cards. Now they cannot do so unless they have someone willing to cosign or can prove they have independent means. Is the limitation on contractual capacity harmful or beneficial for college students of limited means who do not have people to cosign for them? Should these adult students be protected from running up \$5,000 in credit card liability—which could be discharged in bankruptcy—when they are empowered to run up \$200,000 in student loans, which cannot be discharged?

Review Question 4. In his article, *Old Enough to Fight, Old Enough to Swipe: A Critique of the Infancy Rule in the Federal Credit CARD Act*, 2011 UTAH L. REV. 407, Professor Andrew A. Schwartz criticizes the rule by pointing out that recent history is full of successful entrepreneurs who started their successful businesses in their teens—including Bill Gates (Microsoft), Michael Dell (Dell Computer), and Mark Zuckerberg (Facebook). Given that many small startup businesses rely on credit cards for early financing, he argues that denying credit to those under 21 will discourage entrepreneurship. Do you buy Professor Schwartz's argument, or is he making too much out of a few exceptional examples?

ORTELERE v. TEACHERS' RETIREMENT BOARD

New York Court of Appeals
25 N.Y.2d 196, 250 N.E.2d 460, 303 N.Y.S.2d 362 (1969)

BREITEL, J., with whom FULD, C.J. and BURKE and BERGAN, JJ., concur:

[Grace Ortelere was a 60-year-old teacher who had been married for 38 years. She filed for retirement at age 60. The city's pension system allowed married retirees to choose two options to receive benefits: (1) for the lifetime of the retiree or the retiree's spouse, whoever lived longer, or (2) for the lifetime of the retiree alone. The benefit for the second option was higher than for the first. Upon retirement, Ortelere chose the second option. Unfortunately, she died just two months after retiring, which meant that her pension payments terminated. Her husband sued to set aside her benefit selection on the ground that at the time she made the benefit selection she lacked mental capacity to do so. The New York Supreme Court (the trial court in that state) found that Ortelere had been mentally incompetent; the Appellate Division reversed. Ortelere's husband appealed to the Court of Appeals, the highest court in New York.]

Mrs. Ortelere, an elementary schoolteacher since 1924, suffered a "nervous breakdown" in March, 1964 and went on a leave of absence expiring February 5, 1965. She was then 60 years old and had been happily married for 38 years. On July 1, 1964 she came under the care of Dr. D'Angelo, a psychiatrist, who diagnosed her breakdown as involuntional psychosis, melancholia type.³ Dr. D'Angelo prescribed, and for about six weeks decedent underwent, tranquilizer and shock therapy. Although moderately successful, the therapy was not continued since it was suspected that she also suffered from cerebral arteriosclerosis, an ailment later confirmed. However, the psychiatrist continued to see her at monthly intervals until March, 1965. On March 28, 1965 she was hospitalized after collapsing at home from an aneurysm. She died 10 days later; the cause of death was "Cerebral thrombosis due to hypertensive heart disease."

³ ["Involuntional melancholia" is an old term for a kind of depression suffered primarily by post-menopausal women, characterized by anxiety, feelings of guilt, despondency, and fear. At the time of the case, the diagnosed condition was sometimes treated with electroshock therapy. The psychiatrist who treated her, Dr. Ernani d'Angelo, was (according to his New York *Times* obituary) one of the first psychiatrists in the country to do outpatient electroshock therapy for depression. Involuntional melancholia is no longer recognized by the American Psychiatric Association as a psychiatric disorder.—Eds.]

Some years before, on June 28, 1958, she had executed a “Selection of Benefits under Option One” naming her husband as beneficiary of the unexhausted reserve. Under this option upon retirement her allowance would be less by way of periodic retirement allowances, but if she died before receipt of her full reserve the balance of the reserve would be payable to her husband. On June 16, 1960, two years later, she had designated her husband as beneficiary of her service death benefits in the event of her death prior to retirement.

Then on February 11, 1965, when her leave of absence had just expired and she was still under treatment, she executed a retirement application, the one here involved, selecting the maximum retirement allowance payable during her lifetime with nothing payable on or after death. She also, at this time, borrowed from the system the maximum cash withdrawal permitted, namely, \$8,760. Three days earlier she had written the board, stating that she intended to retire on February 12 or 15 or as soon as she received “the information I need in order to decide whether to take an option or maximum allowance.” She then listed eight specific questions, reflecting great understanding of the retirement system, concerning the various alternatives available. An extremely detailed reply was sent, by letter of February 15, 1965, although by that date it was technically impossible for her to change her selection. However, the board’s chief clerk, before whom Mrs. Ortelere executed the application, testified that the questions were “answered verbally by me on February 11th.” Her retirement reserve totaled \$62,165 (after deducting the \$8,760 withdrawal), and the difference between electing the maximum retirement allowance (no option) and the allowance under “option one” was \$901 per year or \$75 per month. That is, had the teacher selected “option one” she would have received an annual allowance of \$4,494 or \$375 per month, while if no option had been selected she would have received an annual allowance of \$5,395 or \$450 per month. Had she not withdrawn the cash the annual figures would be \$5,247 and \$6,148 respectively.

Following her taking a leave of absence for her condition, Mrs. Ortelere had become very depressed and was unable to care for herself. As a result, her husband gave up his electrician’s job, in which he earned \$222 per week, to stay home and take care of her on a full-time basis. She left their home only when he accompanied her. Although he took her to the Retirement Board on February 11, 1965, he did not know why she went, and did not question her for fear “she’d start crying hysterically that I was scolding her. That’s the way she was. And I wouldn’t upset her.”

The Orteleres were in quite modest circumstances. They owned their own home, valued at \$20,000, and had \$8,000 in a savings account. They also owned some farm land worth about \$5,000. Under these circumstances, as revealed in this record, retirement for both of the Orteleres or the survivor of them had to be provided, as a practical matter, largely out of Mrs. Ortelere’s retirement benefits.

According to Dr. D’Angelo, the psychiatrist who treated her, Mrs. Ortelere never improved enough to “warrant my sending her back [to teaching].” A physician

for the Board of Education examined her on February 2, 1965 to determine her fitness to return to teaching. Although not a psychiatrist but rather a specialist in internal medicine, this physician “judged that she had apparently recovered from the depression” and that she appeared rational. However, before allowing her to return to teaching, a report was requested from Dr. D’Angelo concerning her condition. It is notable that the Medical Division of the Board of Education on February 24, 1965 requested that Mrs. Ortelere report to the board’s “panel psychiatrist” on March 11, 1965.

Dr. D’Angelo stated “[at] no time since she was under my care was she ever mentally competent”; that “[mentally] she couldn’t make a decision of any kind, actually, of any kind, small or large.” He also described how involuntional melancholia affects the judgment process: “They can’t think rationally, no matter what the situation is. They will even tell you, ‘I used to be able to think of anything and make any decision. Now,’ they say, ‘even getting up, I don’t know whether I should get up or whether I should stay in bed.’ Or, ‘I don’t even know how to make a slice of toast any more.’ Everything is impossible to decide, and everything is too great an effort to even think of doing. They just don’t have the effort, actually, because their nervous breakdown drains them of all their physical energies.”

While the psychiatrist used terms referring to “rationality,” it is quite evident that Mrs. Ortelere’s psychopathology did not lend itself to a classification under the legal test of irrationality. It is undoubtedly, for this reason, that the Appellate Division was unable to accept his testimony and the trial court’s finding of irrationality in the light of the prevailing rules as they have been formulated.

The well-established rule is that contracts of a mentally incompetent person who has not been adjudicated insane are voidable. Even where the contract has been partly or fully performed it will still be avoided upon restoration of the status quo. *Verstandig v. Schlaffer*, 70 N.E.2d 15 (N.Y. 1946).

Traditionally, in this State and elsewhere, contractual mental capacity has been measured by what is largely a cognitive test. *Aldrich v. Bailey*, 30 N.E. 264 (N.Y. 1892); 2 SAMUEL WILLISTON, LAW OF CONTRACTS § 256 (3D ED. 1960). Under this standard the “inquiry” is whether the mind was “so affected as to render him wholly and absolutely incompetent to comprehend and understand the nature of the transaction.” *Aldrich v. Bailey*, *supra*. A requirement that the party also be able to make a rational judgment concerning the particular transaction qualified the cognitive test. *Paine v. Aldrich*, 30 N.E. 725 (N.Y. 1892). Conversely, it is also well recognized that contractual ability would be affected by insane delusions intimately related to the particular transaction. *Moritz v. Moritz*, 138 N.Y.S. 124 (Sup. Ct. App. Div. 1912), *aff’d* 105 N.E. 1090 (N.Y. 1914).

These traditional standards governing competency to contract were formulated when psychiatric knowledge was quite primitive. They fail to account for one who by

reason of mental illness is unable to control his conduct even though his cognitive ability seems unimpaired. When these standards were evolving it was thought that all the mental faculties were simultaneously affected by mental illness. Milton D. Green, *Public Policies Underlying the Law of Mental Incompetency*, 38 Mich. L. Rev. 1189, 1197-1202 (1940). This is no longer the prevailing view. Note, *Mental Illness and the Law of Contracts*, 57 Mich. L. Rev. 1020, 1033-1036 (1959).

Of course, the greatest movement in revamping legal notions of mental responsibility has occurred in the criminal law. The nineteenth century cognitive test embraced in the *M'Naghten* rules has long been criticized and changed by statute and decision in many jurisdictions. See HENRY WEIHOFEN, MENTAL DISORDER AS A CRIMINAL DEFENSE 65-68 (1954); A.L.I. Model Penal Code § 4.01.

While the policy considerations for the criminal law and the civil law are different, both share in common the premise that policy considerations must be based on a sound understanding of the human mind and, therefore, its illnesses. Hence, because the cognitive rules are, for the most part, too restrictive and rest on a false factual basis they must be re-examined. Once it is understood that, accepting plaintiff's proof, Mrs. Ortelere was psychotic and because of that psychosis could have been incapable of making a voluntary selection of her retirement system benefits, there is an issue that a modern jurisprudence should not exclude, merely because her mind could pass a "cognition" test based on nineteenth century psychology.

It is quite significant that Restatement (Second) of Contracts states the modern rule on competency to contract. This is in evident recognition, and the Reporter's Notes support this inference, that, regardless of how the cases formulated their reasoning, the old cognitive test no longer explains the results. Thus, the new Restatement section reads:

(1) A person incurs only voidable contractual duties by entering into a transaction if by reason of mental illness or defect * * * (b) he is unable to act in a reasonable manner in relation to the transaction and the other party has reason to know of his condition."

Restatement (Second) of Contracts § 18C (Tent. Draft No. No. 1, April 13, 1964).¹ See also RICHARD C. ALLEN, ELYCE ZENOFF FERSTER & HENRY WEIHOFEN, MENTAL IMPAIRMENT AND LEGAL INCOMPETENCY 253, 260-282 (1968); Note, *Mental Illness and the Law of Contracts*, 57 Mich. L. Rev. 1020, 1036 (1959), where it is recommended "that a complete test for contractual incapacity should provide protection to those persons whose contracts are merely uncontrolled reactions to their mental illness, as

¹ [In the final version of the Restatement (Second) of Contracts, this provision was renumbered as section 15. As it happens, the author of this opinion, Charles Breitel, was a member of the committee that drafted the Second Restatement, and *Ortelere* was the first case to rely on section 15. The drafters promptly made the facts of the *Ortelere* case as "Illustration 1" to the new section.—Eds.]

well as for those who could not understand the nature and consequences of their actions.”

The avoidance of duties under an agreement entered into by those who have done so by reason of mental illness, but who have understanding, depends on balancing competing policy considerations. There must be stability in contractual relations and protection of the expectations of parties who bargain in good faith. On the other hand, it is also desirable to protect persons who may understand the nature of the transaction but who, due to mental illness, cannot control their conduct. Hence, there should be relief only if the other party knew or was put on notice as to the contractor’s mental illness. Thus, the Restatement provision for avoidance contemplates that “the other party has reason to know” of the mental illness.

When, however, the other party is without knowledge of the contractor’s mental illness and the agreement is made on fair terms, the proposed Restatement rule is:

The power of avoidance under subsection (1) terminates to the extent that the contract has been so performed in whole or in part or the circumstances have so changed that avoidance would be inequitable. In such a case a court may grant relief on such equitable terms as the situation requires.

Restatement, *supra*, § 18C.

The system was, or should have been, fully aware of Mrs. Ortelere’s condition. They, or the Board of Education, knew of her leave of absence for medical reasons and the resort to staff psychiatrists by the Board of Education. Hence, the other of the conditions for avoidance is satisfied.

Lastly, there are no significant changes of position by the system other than those that flow from the barest actuarial consequences of benefit selection.

Nor should one ignore that in the relationship between retirement system and member, and especially in a public system, there is not involved a commercial, let alone an ordinary commercial, transaction. Instead the nature of the system and its announced goal is the protection of its members and those in whom its members have an interest. It is not a sound scheme which would permit 40 years of contribution and participation in the system to be nullified by a one-instant act committed by one known to be mentally ill. This is especially true if there would be no substantial harm to the system if the act were avoided. On the record none may gainsay that her selection of a “no option” retirement while under psychiatric care, ill with cerebral arteriosclerosis, aged 60, and with a family in which she had always manifested concern, was so unwise and foolhardy that a factfinder might conclude that it was explainable only as a product of psychosis.

On this analysis it is not difficult to see that plaintiff's evidence was sufficient to sustain a finding that, when she acted as she did on February 11, 1965, she did so solely as a result of serious mental illness, namely, psychosis. Of course, nothing less serious than medically classified psychosis should suffice or else few contracts would be invulnerable to some kind of psychological attack. Mrs. Ortelere's psychiatrist testified quite flatly that as an involuntional melancholiac in depression she was incapable of making a voluntary "rational" decision. Of course, as noted earlier, the trial court's finding and perhaps some of the testimony attempted to fit into the rubrics of the traditional rules. For that reason rather than reinstatement of the judgment at Trial Term there should be a new trial under the proper standards frankly considered and applied.

Accordingly, the order of the Appellate Division should be reversed, without costs, and the action remanded to Trial Term for a new trial.

JASEN, J., with whom SCILEPPI, J., concurs, dissenting:

Where there has been no previous adjudication of incompetency, the burden of proving mental incompetence is upon the party alleging it. I agree with the majority at the Appellate Division that the plaintiff, the husband of the decedent, failed to sustain the burden incumbent upon him of proving deceased's incompetence.

The evidence conclusively establishes that the decedent, at the time she made her application to retire, understood not only that she was retiring, but also that she had selected the maximum payment during her lifetime.

Indeed, the letter written by the deceased to the Teachers' Retirement System prior to her retirement demonstrates her full mental capacity to understand and to decide whether to take an option or the maximum allowance. The full text of the letter reads as follows:

February 8, 1965

* * *

Gentlemen:

I would like to retire on Feb. 12 or Feb. 15. In other words, just as soon as possible after I receive the information I need in order to decide whether to take an option or maximum allowance. Following are the questions I would like to have answered:

1. What is my "average" five-year salary?
2. What is my maximum allowance?
3. I am 60 years old. If I select option four-a with a beneficiary (female) 27 years younger, what is my allowance?
4. If I select four-a on the pension part only, and take the maximum annuity, what is my allowance?

5. If I take a loan of 89% of my year's salary before retirement, what would my maximum allowance be?

6. If I take a loan of \$5,000 before retiring, and select option four-a on both the pension and annuity, what would my allowance be?

7. What is my total service credit? I have been on a leave without pay since Oct. 26, 1964.

8. What is the 'factor' used for calculating option four-a with the above beneficiary?

Thank you for your promptness in making the necessary calculations. I will come to your office on Thursday afternoon of this week.

It seems clear that this detailed, explicit and extremely pertinent list of queries reveals a mind fully in command of the salient features of the Teachers' Retirement System. Certainly, it cannot be said that the decedent could possess sufficient capacity to compose a letter indicating such a comprehensive understanding of the retirement system, and yet lack the capacity to understand the answers.

As I read the record, the evidence establishes that the decedent's election to receive maximum payments was predicated on the need for a higher income to support two retired persons—her husband and herself. Since the only source of income available to decedent and her husband was decedent's retirement pay, the additional payment of \$75 per month which she would receive by electing the maximal payment was a necessity. Indeed, the additional payments represented an increase of 20% over the benefits payable under option 1. Under these circumstances, an election of maximal income during decedent's lifetime was not only a rational, but a necessary decision.

Further indication of decedent's knowledge of the financial needs of her family is evidenced by the fact that she took a loan for the maximum amount (\$8,760) permitted by the retirement system, at the time she made application for retirement. Moreover, there is nothing in the record to indicate that the decedent had any warning, premonition, knowledge or indication at the time of retirement that her life expectancy was, in any way, reduced by her condition.

Decedent's election of the maximum retirement benefits, therefore, was not so contrary to her best interests so as to create an inference of her mental incompetence. Indeed, concerning election of options under a retirement system, it has been held: "Even where no previous election has been made, the court must make the election for an incompetent which would be in accordance with what would have been his manifest and reasonable choice if he were sane, and, in the absence of convincing evidence that the incompetent would have made a different selection, *it is presumed that he would have chosen the option yielding the largest returns in his lifetime.*" *Schwartzberg v. Teachers' Retirement Bd.*, 76 N.Y.S.2d 488 (Sup. Ct. App. Div.), *aff'd* 83 N.E.2d 146 (N.Y. 1948) (emphasis supplied).

Nor can I agree with the majority's view that the traditional rules governing competency to contract "are, for the most part, too restrictive and rest on a false factual basis."

The issue confronting the courts concerning mental capacity to contract is under what circumstances and conditions should a party be relieved of contractual obligations freely entered. This is peculiarly a legal decision, although, of course, available medical knowledge forms a datum which influences the legal choice. It is common knowledge that the present state of psychiatric knowledge is inadequate to provide a fixed rule for each and every type of mental disorder. Thus, the generally accepted rules which have evolved to determine mental responsibility are general enough in application to encompass all types of mental disorders, and phrased in a manner which can be understood and practically applied by juries composed of laymen.

The generally accepted test of mental competency to contract which has thus evolved is whether the party attempting to avoid the contract was capable of understanding and appreciating the nature and consequences of the particular act or transaction which he challenges. *Schwartzberg, supra*. This rule represents a balance struck between policies to protect the security of transactions between individuals and freedom of contract on the one hand, and protection of those mentally handicapped on the other hand. In my opinion, this rule has proven workable in practice and fair in result. In the final analysis, the lay jury will infer the state of the party's mind from his observed behavior as indicated by the evidence presented at trial. Each juror instinctively judges what is normal and what is abnormal conduct from his own experience, and the generally accepted test harmonizes the competing policy considerations with human experience to achieve the fairest result in the greatest number of cases.

As in every situation where the law must draw a line between liability and nonliability, between responsibility and nonresponsibility, there will be borderline cases, and injustices may occur by deciding erroneously that an individual belongs on one side of the line or the other. To minimize the chances of such injustices occurring, the line should be drawn as clearly as possible.

The Appellate Division correctly found that the deceased was capable of understanding the nature and effect of her retirement benefits, and exercised rational judgment in electing to receive the maximum allowance during her lifetime. I fear that the majority's refinement of the generally accepted rules will prove unworkable in practice, and make many contracts vulnerable to psychological attack. Any benefit to those who understand what they are doing, but are unable to exercise self-discipline, will be outweighed by frivolous claims which will burden our courts and undermine the security of contracts. The reasonable expectations of those who innocently deal with persons who appear rational and who understand what they are doing should be protected.

Accordingly, I would affirm the order appealed from.

Review Question 5. In *McGovern v. Commonwealth*, 512 Pa. 377, 517 A.2d 523 (1986), a case with nearly identical facts, the Pennsylvania Supreme Court rejected *Ortelere*, and refused to adopt the Restatement § 15 test. The court reiterated the traditional test:

Under Pennsylvania law, it is presumed that an adult is competent to enter into an agreement, and a signed document gives rise to the presumption that it accurately expresses the state of mind of the signing party.” Mere mental weakness, if it does not amount to inability to comprehend the contract, and is unaccompanied by evidence of imposition or undue influence, is insufficient to set aside a contract. Finally, a presumption of mental incapacity does not arise merely because of an unreasonable or unnatural disposition of property.

Both *Ortelere* and *McGovern* are 4-2 decisions with strong dissents. Which one is the better approach and why?

Problems

Problem 13.1

Steven is seventeen, is 6’2” and 230 pounds with a short goatee, and he looks to be in his mid-20s. He has been married to his high school sweetheart Tabitha for six months; they have a newborn daughter named Abby. Steven has just dropped out of high school to take a good job in the oil fields, which allows him to support his new family. He plans to get his GED in his spare time. For his job, however, he needs a reliable car to get to and from the oilfields, where there is no public transportation. His old Chevy Impala has not been suitable.

Steven goes to Car Dealer, and signs a contract to purchase a new red Ford Mustang for \$22,000. In entering the transaction he shows Dealer a fake driver’s license which shows him as being 20 years old. Through Dealer, he secures a loan to pay for the car, which gives him monthly payments of \$423.

A few days after he turns 18, Steven decides he no longer likes the Mustang. Dust, grit, and particulate matter in the oilfields have already begun to scratch up the paint, there are significant scratches on the bumpers, and he now thinks he would

prefer a pickup truck. He wants to disaffirm the contract and get his money back. He returns the car to Dealer. The age of majority in the state is 18.

What are Steven's arguments that he should be able to get out of the contract and get his money back? What are the dealer's arguments that he should be required to keep the car and make the payments he promised to make?

Problem 13.2

Roman has just turned 17. His father has given him an old Honda Civic to drive. The car is registered in Roman's name. Under state law, Roman is required to buy auto insurance that provides for \$30,000 of liability coverage. The policy has a provision, standard in such contracts, providing that the claim will not be paid unless notice is given to the insurance company within 60 days of the accident giving rise to the claim. The provision is designed to permit the insurance company to investigate the claim promptly and prior court decisions have held that it is reasonable. Roman purchases the policy. He indicates on the policy that he is 18, but no identification is required.

A few weeks later Roman is driving when his car crosses the center divider and hits an oncoming car. Both cars are totaled; two persons in the other vehicle are injured, one of whom requires hospitalization for a week. Roman is ticketed for the offense. He does not report the matter to his insurance company because he believes his premiums will go up.

Several months later, just before his eighteenth birthday, Roman he is sued by the driver of the other car. He finally notifies the insurance company, which declines coverage because he did not give the required notice. Roman tells the insurance company that the accident was actually caused by the fact that the car for some reason stopped responding to the steering wheel, probably due to some defect. Roman's car was, however, taken to a scrap yard and junked six months after the accident, so it is impossible to tell what happened.

Can Roman make the insurance company pay? Why or why not?

Problem 13.3

Sherman is a money manager in New York. He is brilliant and successful, but he has always suffered from bipolar disorder, which means that his mood will often swing sharply between almost manic enthusiasm and bouts of deep depression. In recent years the disorder has become more severe. He has prescription medication to deal with it, but he is not good about taking the medication regularly.

One day, while playing golf at a private course where he was taken by a friend, he starts chatting with the clubhouse manager. The manager mentions that the club

has not been profitable lately and that the property is for sale, perhaps to a developer who will convert it into another use. Sherman is intensely interested. He immediately calls the club president, who puts him in touch with the real estate broker who is representing the property. He meets with the broker a few hours later, gets a few more details. On the spot he agrees to buy the property. He tells the broker that he will pay the full listed price of \$3.2 million provided they can get the deal done that evening, saying that he does not want anyone else to have a chance at it.

The broker is surprised by the speed of his decision. Sherman waves a hand, gives her a business card, and explains what he does. As a high-level money manager, he is used to making quick decisions, he says, and this is, for him, a relatively small-potatoes deal. When you wait around, he says, you lose the chance for a great deal. He who hesitates is lost. A couple of hundred thousand on the purchase price, he says (waving a hand airily) will not make much of a difference in the success of the project he has in mind. He does not say exactly what the project is he has in mind.

The broker, excusing herself for a few minutes, ostensibly to go to the restroom, does a quick Internet check and determines that Sherman is exactly who he says he is. She finds him to be loud and overbearing and thinks he laughs too much—sometimes for no apparent reason—but his credit is good. She quickly prepares a brief memorandum which they both sign. Sherman hands her a personal check for \$50,000 as earnest money. The next day she deposits the check and it clears without difficulty.

Right about the same time, though, Sherman tries to kill himself with a kitchen knife, slashing his wrists in the bathtub. He is not successful. Discovered by his housekeeper, he is rushed to the hospital for treatment. He is examined thoroughly. Physicians from the hospital will testify he had previously tried to kill himself and had stopped taking his medication. On the night of the golf course deal, they will testify, Sherman was under the influence of his disorder and unable to make fully rational decisions.

Sherman wants to get out of the golf course deal, saying that he was in the manic stage of his disorder and should not be held to the deal. The golf course owners want to hold him to it.

Can Sherman void the deal on grounds of incapacity? How would this problem come out if Pennsylvania law (see Review Question 5, above) or the approach of the *Ortelere* dissent applied, rather than the New York law stated by the *Ortelere* majority?

Unit 14: The Statute of Frauds

CONTRACT DEFENSES Part Two

FOCUS OF THIS UNIT

The thing that lawyers call *the* statute of frauds is actually misnamed. In the United States, hundreds upon hundreds of statutes of frauds are in existence because “statute of frauds” is the term that has come to be used for any requirement that certain legal documents be in writing to be effective. The rules on the books today (and the vast majority of them are in the form of a statute) do, however, all descend from a single act of Parliament that we may correctly call *the* Statute of Frauds, and it is the starting point to understand writing requirements in American contract law today.

Begin When Writing Was Rare. In the early days of English law—the first few hundred years after the Norman Conquest, relatively few contracts were in writing because relatively few people could write. In Property class, you may have heard about conveying land by *livery of seisin*, the transfer or formally handing over a piece of the sod in front of witnesses. In an age when almost no laymen (or nobles, for that matter) could write, most deals were oral.

Over time, however, growth in trade and education meant that writings became more common and important, and more people sought to memorialize major transactions with a writing. This was helped by a system of creating deeds that could be recorded, so that people (especially the tax collectors) could tell who owned what. Writing had obvious advantages over oral transactions, since the latter depended on memory (which could be faulty) and on the honesty of the witnesses (which was not always perfect). Because of the intricacies of British judicial procedure, a class of professional witnesses would actually hang around courts of law waiting for work. They would willingly swear to anything, so long as they were paid for doing so. This situation created fertile grounds for fraud.

Parliament Acts. In 1677, Parliament passed (with the assent of King Charles II) “An act for prevention of many Fraudulent Practices which are commonly endeavoured to be upheld by Perjury and Subornation of Perjury”—which became

known as the Statute of Frauds. It required that certain kinds of transactions—those of most interest to the powerful landowners who dominated the Parliament of the day—be put in writing or else be unenforceable.

Land, for example, was the principal measure of wealth in England. A tenant farmer could claim that his local landlord had promised to sell him the land he farmed for £100. The farmer could bring in paid witnesses to swear to the deal, and the landlord might lose. Landlords wanted these transactions in writing. Similarly, the family structure of the upper classes meant that in important families there would be a single head who, through primogeniture, would own most of the family property. This means that anyone owed anything by a member of the family would always try to seek some way of holding the rich head of the family liable. Thus, someone who had loaned money to a younger son might try to prove that the head of the family had agreed to stand surety for son's debts, which again could easily be proved by oral testimony. Or when the head of the family was appointed executor for a junior member of the family who died in debt, the decedent's creditors might claim that the head of the family had promised to pay the creditors out of the head's own large fortune, rather than the deceased's own small estate. Similarly, in a large household with often hundreds of employees, it was easy for a butler or gardener to claim that the head of the family had promised him a lifetime contract. Finally, given that most marriages in upper-class families were arranged, and were accompanied by complex financial arrangements, it was not uncommon for the family of the bride or groom to claim that the other party's family had orally promised to provide the new couple with some estate or with some amount of money.

Thus, these heads of the family—who made up the House of Lords and most of the House of Commons—required that these sorts of contracts be in writing to be enforceable.

The English Statute Comes to America. The first American states received the original English statute of frauds because they were English colonies when the law was passed. Later states legislatively or judicially adopted the rules from these first colonies. Since 1677, the idea of a writing requirement for certain contracts has been extremely popular with legislatures, who have crafted thousands of specific requirements that certain legal documents be put in writing to be enforceable.

The Statute FOR Frauds? A requirement of a writing sometimes does indeed keep people from being bound by contracts to which they never agreed, and in that regard, statutes of frauds live up to their name and prevent fraud. Consider, however, that the writing requirement sometimes allows a party who actually *has* agreed to a contract to escape liability because the agreement was not reduced to a writing. Even if fifty eyewitnesses could accurately testify as to what the promisor orally contracted to do, the contract would not be enforceable. Judges eventually found it irksome that a party could escape liability on this kind of “technicality” when all the other

requirements of a contract were met. Over time judges began shrinking the scope of the statute and inventing exceptions for certain sets of facts. While many judges strongly support the idea of the statute, many others would like to see it abolished, being convinced that it causes more fraud than it prevents. The Restatement (Second) of Contracts has an entire chapter entitled the “The Statute of Frauds” covering sections 110 through 150. Skimming that chapter will give you some idea of the scope and extent of exceptions that have developed.

The British Parliament effectively repealed the original Statute of Frauds in 1954, so it no longer applies in the place of its birth. The United Nations Convention on the International Sale of Goods also does not contain a requirement that contracts be in writing. Statutes of frauds are, however, alive and well in the United States, creating an area where American contract law differs significantly both from civil code countries (like most of Continental Europe, for instance) and even from other common law countries. To be clear, contracts in other legal systems commonly *are* in writing and those writings are given effect. Everyone recognizes that a writing can add certainty to a transaction. The rest of the world is simply not as enamored with the *requirement* of a writing as Americans are.

What Does It Mean To Be Within the Statute? Samuel Goldwyn, the movie mogul, allegedly once said that “An oral contract isn’t worth the paper it’s written on.” By now you should know that Goldwyn’s statement is not entirely accurate. Oral contracts are just as enforceable as written ones—*unless* they fall within the statute. Notice that language. A contract is said to be “within the statute” if a writing is required. If a contract is the kind for which no writing is required, such as an employment contract for a year, it is not “within” the statute.

Standing on MY LEGS. Two broad kinds of questions arise under the statute of frauds. The first is *which* contracts are covered. The second is *what counts* as a suitable signed writing. A complete list of contracts where writings are required would vary greatly from state to state. Nonetheless, six “classic” categories derive from the original English statute and are so common in American jurisdictions that they are embodied in the overall list contained in section 110 of the Restatement (Second) of Contracts and—for sales of goods—section 2-201 of the Uniform Commercial Code. You should read those two legal authorities now.

Law students for generations have memorized these six categories, many of them using the mnemonic MY LEGS, which we offer you in the list below. We recommend that you briefly review the Restatement and the UCC sections cited in the list.

M Contracts in contemplation of *MARRIAGE*. This rule covers, for example, prenuptial agreements or family promises to convey property to the new couple. *See* Restatement (Second) of Contracts § 124.

Y Contracts that cannot be performed within one *YEAR* of the contract's date. *See* Restatement (Second) of Contracts § 130.

L Contracts involving the sale of *LAND* and (varying by the state) other kinds of interests in land, such as easements and mineral rights. *See* Restatement (Second) of Contracts §§ 125-129.

E Contracts of *EXECUTORS* to pay debts out of the executors' own pockets. Note that this rule does not apply to promises to pay debts out of the decedent's estate, but only out of the executor's *personal* resources. *See* Restatement (Second) of Contracts §§ 111.

G Contracts for sales of *GOODS* above \$500.¹ Recall that the Uniform Commercial Code defines goods are things that are "tangible" and "moveable," which does not include real estate, services, and intangible legal rights. *See* Uniform Commercial Code § 2-201.

S *SURETYSHIP* contracts. These are contracts under which one party agrees to be liable for the debts of someone else. The most common type is what you know as a "co-signer" on a loan, but there are other types. *See* Restatement (Second) of Contracts §§ 112-123.

If a contract falls into one of these categories, it is not enforceable unless it meets the requirements of the statute.

What Kind of Writing Satisfies the Statute? Once a contract is within the Statute of Frauds, we must determine what exactly qualifies as a *sufficient writing* for purposes of the statute. A writing that satisfies the statute might not, for example, necessarily contain all the terms of the parties contract. A qualifying writing generally must be *signed* or otherwise *subscribed* by the person who is said to be bound by the deal.

These issues were simple to address in 1677: all legal documents were handwritten and either hand-signed or formally sealed by the parties. Introduction of new technologies since that time—pre-printed forms, telegraphs, fax machines, electronic mail, digital ordering systems, text messaging, and more—has made statute of frauds issues more complicated at times. Both the U.S. Congress and state legislatures have tried to bridge the gap between the statute of frauds and the digital age with statutes providing for the treatment of electronic messages. Prominent examples of legislation on point include the state-law Uniform Electronic Transactions Act ("UETA"), excerpted later in these materials, and the federal

¹ [A proposal in 2003 to substantially revise and update UCC Article 2 would have raised this amount to \$5,000. For reasons we won't bore you with at the moment, Revised Article 2 failed to gain any traction in state legislatures was ultimately withdrawn by its drafters. Hence, the Article 2 statute of frauds threshold remains at \$500, capturing many smaller deals that the original statute wasn't intended to reach. – Eds.]

Electronic Signatures in Global and National Commerce Act (“E-Sign”), the latter of which is found at 15 U.S.C. §§ 7001-7006 (2012).

Cases and Materials

Review Question 1. Based on the introduction and the legal materials to which you were cited, determine whether each of the following contracts is within the statute of frauds and whether it would be enforced in a U.S. court absent a sufficient writing:

- a. A \$50,000 second mortgage, payable in 10 years, taken out on a family home.
- b. A one-year employment contract signed on June 1 which will go into effect on July 1.
- c. A promise by the mother of a daughter who was killed in an auto accident to pay a claim herself if the claimant agrees not to bring a claim against the daughter’s estate.
- d. A contract to purchase a one-ounce gold coin.
- e. A contract to pay the total cost of a student’s law school tuition.
- f. A parent’s promise to guarantee payment of a loan taken out by a minor to purchase a car.
- g. An antenuptial (or “prenuptial”) agreement providing for the distribution of property among the spouses in the event of a divorce.
- h. A promise by a bride’s family to pay a dowry to the husband upon the couple’s marriage in a country where dowries are still common.
- i. A contract to allow the buyer to remove 50,000 cubic feet of clay from a piece of real estate in exchange for \$20,000.
- j. A contract for an around-the-world cruise that will cost \$10,000.
- k. A contract to landscape a home at a total price of \$12,000.
- l. A contract for a roundtrip excursion to the star system Alpha Centauri, which is 4.367 light years away.

Review Question 2. Read section 139 of the Restatement (Second) of Contracts, entitled “Enforcement by Virtue of Action in Reliance.” This provision should sound familiar to you from your previous experience with section 90. What do you think the consideration doctrine and the statute of frauds have in common that

would give rise to these exceptions?

McINERNEY v. CHARTER GOLF, INC.

Supreme Court of Illinois
176 Ill. 2d 482, 680 N.E.2d 1347 (1997)

HEIPLE, J.

From 1988 through 1992, Dennis McInerney worked as a sales representative for Charter Golf, Inc., a company which manufactures and sells golf apparel and supplies. Initially, McInerney's territory included Illinois but was later expanded to include Indiana and Wisconsin. In 1989, McInerney allegedly was offered a position as an exclusive sales representative for Hickey-Freeman, an elite clothier which manufactured a competing line of golf apparel. Hickey-Freeman purportedly offered McInerney an 8% commission.

Intending to inform Charter Golf of his decision to accept the Hickey-Freeman offer of employment, McInerney called Jerry Montiel, Charter Golf's president. Montiel wanted McInerney to continue to work for Charter Golf and urged McInerney to turn down the Hickey-Freeman offer. Montiel promised to guarantee McInerney a 10% commission on sales in Illinois and Wisconsin "for the remainder of his life," in a position where he would be subject to discharge only for dishonesty or disability. McInerney allegedly accepted Charter Golf's offer and, in exchange for the guarantee of lifetime employment, gave up the Hickey-Freeman offer. McInerney then continued to work for Charter Golf.

In 1992, the relationship between Charter Golf and McInerney soured: Charter Golf fired McInerney. McInerney then filed a complaint in the circuit court of Cook County, alleging breach of contract. The trial court granted Charter Golf's motion for summary judgment after concluding that the alleged oral contract was unenforceable under the statute of frauds because the contract amounted to an agreement which could not be performed within a year from its making. The appellate court affirmed, but on a wholly different ground.²

Charter Golf argues that the oral contract at issue in this case violates the statute of frauds and is unenforceable because it is not capable of being performed within one year of its making. By statute in Illinois, "no action shall be brought * * *

² [The intermediate appellate court held that there was no consideration for the promise of lifetime employment. In a part of this opinion not included here, the court held that there was, in fact, consideration for the promise. -Eds.]

upon any agreement that is not to be performed within the space of one year from the making thereof, unless * * * [the agreement is] in writing and signed by the party to be charged.” 740 Ill. Cons. Stat. 80/1 (West 1994). Our statute tracks the language of the original English Statute of Frauds and Perjuries. 29 Charles II ch. 3 (1676). The English statute enacted by Parliament had as its stated purpose the prohibition of those “many fraudulent practices, which are commonly endeavored to be upheld by perjury and subordination of perjury.” Illinois’ statute of frauds seeks to do the same by barring actions based upon nothing more than loose verbal statements.

The period of one year, although arbitrary, recognizes that with the passage of time evidence becomes stale and memories fade. The statute proceeds from the legislature’s sound conclusion that while the technical elements of a contract may exist, certain contracts should not be enforced absent a writing. It functions more as an evidentiary safeguard than as a substantive rule of contract. As such, the statute exists to protect not just the parties to a contract, but also—perhaps more importantly—to protect the fact finder from charlatans, perjurers and the problems of proof accompanying oral contracts.

There are, of course, exceptions to the statute of frauds’ writing requirement that permit the enforcement of certain oral contracts required by the statute to be in writing. One such exception is the judicially created exclusion for contracts of uncertain duration. In an effort to significantly narrow the application of the statute, many courts have construed the words “not to be performed” to mean “not capable of being performed” within one year. *See* Restatement (Second) of Contracts § 130 (1981). These cases hold that if performance is possible by its terms within one year, the contract is not within the statute regardless of how unlikely it is that it will actually be performed within one year. Under this interpretation, the actual course of subsequent events and the expectations of the parties are entirely irrelevant. Restatement (Second) of Contracts § 130, Comment a (1981). A contract for lifetime employment would then be excluded from the operation of the statute because the employee could, in theory, die within one year, and thus the contract would be “capable of being performed.”

We find such an interpretation hollow and unpersuasive. A “lifetime” employment contract is, in essence, a permanent employment contract. Inherently, it anticipates a relationship of long duration—certainly longer than one year. In the context of an employment-for-life contract, we believe that the better view is to treat the contract as one “not to be performed within the space of one year from the making thereof.” To hold otherwise would eviscerate the policy underlying the statute of frauds and would invite confusion, uncertainty and outright fraud. Accordingly, we hold that a writing is required for the fair enforcement of lifetime employment contracts.

NICKELS, J., dissenting.

I disagree with the majority's holding that the employment contract in the case at bar must be in writing because it falls within the requirements of the Statute of Frauds.

The writing requirement applies to “any agreement that is not to be performed within the space of one year from the making thereof.” Commenting on this language, the Restatement (Second) of Contracts observes:

[T]he enforceability of a contract under the one-year provision does not turn on the actual course of subsequent events, nor on the expectations of the parties as to the probabilities. Contracts of uncertain duration are simply excluded; the provision covers only those contracts whose performance cannot possibly be completed within a year.

Rest. 2d. Contracts § 130, cmt. a.

A contract of employment for life is necessarily one of uncertain duration. Since the employee's life may end within one year, and, as the majority acknowledges, the contract would be fully performed upon the employee's death, the contract is not subject to the statute of frauds' one-year provision. *See* Rest. 2d § 130, illus. 2; *see also* 72 AM. JUR. 2D, *Statute of Frauds* § 14 (1974) (“The rule generally accepted by the authorities is that an agreement or promise the performance or duration of which is contingent on the duration of human life is not within the statute”); JOHN D. CALAMARI & JOSEPH M. PERILLO, *THE LAW OF CONTRACTS* § 19-20 (3d ed. 1987) (“if A promises *** to employ X for life, the promise is not within the Statute because it is not for a fixed term and the contract by its terms is conditioned upon the continued life of X and the condition may cease to exist within a year because X may die within a year”). It is irrelevant whether the parties anticipate that the employee will live for more than a year or whether the employee actually does so.

The majority acknowledges that “many courts” subscribe to this view. More accurately, the Restatement rule represents “the prevailing interpretation” of the statute of frauds' one-year provision. Restatement (Second) of Contracts § 130, Comment a, at 328 (1981). Only a “distinct minority” of cases have ascribed significance to whether the parties expected that a contract would take more than a year to perform. CALAMARI & PERILLO, § 19-18, at 808. According to Williston on Contracts:

It is well settled that the oral contracts invalidated by the Statute because not to be performed within a year include only those which cannot be performed within that period. A promise which is not likely to be performed within a year, and which in fact is not performed within a year, is not within the Statute if at the time the contract is made there is a possibility in law and in fact that full performance such as the parties intended may be completed before the expiration of a year.

In the leading case on this section of the Statute the Supreme Court of the United States said: “The parties may well have expected that the contract would continue in force for more than one year; it may have been very improbable that it would not do so; and it did in fact continue in force for a much longer time. But they made no stipulation which in terms, or by reasonable inference, required that result. The question is not what the probable, or expected, or actual performance of the contract was; but whether the contract, according to the reasonable interpretation of its terms, required that it should not be performed within the year.”

3 W. JAEGER, WILLISTON ON CONTRACTS § 495 at 575-79 (3d ed. 1960), *quoting Warner v. Texas & Pacific Ry. Co.*, 164 U.S. 418 (1896).

Although the majority brands this interpretation “hollow and unpersuasive,” it has a sound basis in the plain language of the statute. Corbin notes:

[Courts] have observed the exact words of [the one-year] provision and have interpreted them literally and very narrowly. The words are “agreement that is not to be performed.” They are not “agreement that is not in fact performed” or “agreement that may not be performed” or “agreement that is not at all likely to be performed.” To fall within the words of the provision, therefore, the agreement must be one of which it can truly be said at the very moment that it is made, “This agreement is not to be performed within one year”; in general, the cases indicate that there must not be the slightest possibility that it can be fully performed within one year.”

2 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 444, at 535 (1950).

Courts have tended to give the one-year provision a narrow construction precisely because of the lack of a discernable rationale for it. See Rest. 2d § 130, cmt. a (“The design was said to be not to trust to the memory of witnesses for a longer time than one year, but the statutory language was not appropriate to carry out that purpose. The result has been a tendency to construction narrowing the application of the statute”). I am inclined to do likewise. Since the one-year provision is so poorly suited to the aims it was ostensibly designed to accomplish, I see no compelling reason to expand the provision’s scope beyond the class of contracts to which it applies by its terms. The narrow and literal interpretation that most courts have given to the language of the one-year provision is entirely appropriate under these circumstances.

Review Question 3. The facts of the *McInerney* case cut across many of the policy disputes that arise in connection with application of a writing requirement for contracts. What is the real purpose of the requirement? If a party can adequately

prove the existence of a contract in another way, is it fair to *require* a writing? Should the legal system reward formality and penalize less formal deal-making? If you think the answer to the previous question is “yes,” then does that make you part of the problem many people have with transactional lawyers—that they slow down deals and make them more expensive?

CRABTREE v. ELIZABETH ARDEN SALES CORP.

Court of Appeals of New York
305 N.Y. 48, 110 N.E.2d 551 (1953)

FULD, J.

In September of 1947, Nate Crabtree entered into preliminary negotiations with Elizabeth Arden Sales Corporation, manufacturers and sellers of cosmetics, looking toward his employment as sales manager. Interviewed on September 26th, by Robert P. Johns, executive vice-president and general manager of the corporation, who had apprised him of the possible opening, Crabtree requested a three-year contract at \$25,000 a year. Explaining that he would be giving up a secure well-paying job to take a position in an entirely new field of endeavor—which he believed would take him some years to master—he insisted upon an agreement for a definite term. And he repeated his desire for a contract for three years to Miss Elizabeth Arden, the corporation’s president.³ When Miss Arden finally indicated that she was prepared to offer a two-year contract, based on an annual salary of \$20,000 for the first six months, \$25,000 for the second six months and \$30,000 for the second year, plus expenses of \$5,000 a year for each of those years, Crabtree replied that that offer was “interesting.” Miss Arden thereupon had her personal secretary make this memorandum⁴ on a telephone order blank that happened to be at hand:

EMPLOYMENT AGREEMENT WITH
NATE CRABTREE Date Sept 2-1947
At 681-5th Ave 6: PM

³[“Elizabeth Arden” was the trade name adopted by Florence Nightingale Graham (1884-1966), who grew up in a small farming town in Canada, dropped out of nursing school, started her first salon on Fifth Avenue in New York City in 1909. She was featured on the cover of *Time* Magazine in 1946. – Eds.]

⁴[Confession time: We put the secretary’s memorandum in a “handwriting font” for visual impact and to make it stand out in the opinion. It doesn’t *actually* appear that way in the case reporter. We use the same trick elsewhere in the opinion. Now continue reading and pay no further attention to that man behind the curtain. – Eds.]

* * *

Begin	20000.
6 months	25000.
6 months	30000.

5000.-per year
Expense money
[2 years to make good]
Arrangement with
Mr Crabtree
By Miss Arden
Present Miss Arden
Mr John
Mr Crabtree
Miss OLeary

A few days later, Crabtree “phoned Mr. Johns and telegraphed Miss Arden; he accepted the ‘invitation to join the Arden organization,’” and Miss Arden wired back her “welcome.” When he reported for work, a “pay-roll change” card was made up and initialed by Mr. Johns, and then forwarded to the payroll department. Reciting that it was prepared on September 30, 1947, and was to be effective as of October 22d, it specified the names of the parties, Crabtree’s “Job Classification” and, in addition, contained the notation that

“This employee is to be paid as follows:

First six months of employment \$20,000. per annum

Next six months of employment 25,000. per annum

After one year of employment 30,000. per annum

Approved by RJD [initialed]”

After six months of employment, Crabtree received the scheduled increase from \$20,000 to \$25,000, but the further specified increase at the end of the year was not paid. Both Mr. Johns and the comptroller of the corporation, Mr. Carstens, told Crabtree that they would attempt to straighten out the matter with Miss Arden, and, with that in mind, the comptroller prepared another “pay-roll change” card, to which his signature is appended, noting that there was to be a “Salary increase” from \$25,000 to \$30,000 a year, “per contractual arrangements with Miss Arden.” The latter, however, refused to approve the increase and, after further fruitless discussion, plaintiff left defendant’s employ and commenced this action for breach of contract.

At the ensuing trial, defendant denied the existence of any agreement to employ plaintiff for two years, and further contended that, even if one had been made,

the statute of frauds barred its enforcement. The trial court found against defendant on both issues and awarded plaintiff damages of about \$14,000, and the Appellate Division, two justices dissenting, affirmed. Since the contract relied upon was not to be performed within a year, the primary question for decision is whether there was a memorandum of its terms, subscribed by defendant, to satisfy the statute of frauds.

Each of the two payroll cards—the one initialed by defendant’s general manager, the other signed by its comptroller—unquestionably constitutes a memorandum under the statute. That they were not prepared or signed with the intention of evidencing the contract, or that they came into existence subsequent to its execution, is of no consequence. *See Marks v. Cowdin*, 123 N.E. 139 (N.Y. 1919). It is enough, to meet the statute’s demands, that they were signed with intent to authenticate the information contained therein and that such information does evidence the terms of the contract. Those two writings contain all of the essential terms of the contract—the parties to it, the position that plaintiff was to assume, the salary that he was to receive—except that relating to the duration of plaintiff’s employment. Accordingly, we must consider whether that item, the length of the contract, may be supplied by reference to the earlier unsigned office memorandum, and, if so, whether its notation, “2 years to make good,” sufficiently designates a period of employment.

The statute of frauds does not require the “memorandum * * * to be in one document. It may be pieced together out of separate writings, connected with one another either expressly or by the internal evidence of subject matter and occasion.” *Marks v. Cowdin*, *supra*; see also Restatement, Contracts, § 208(a) (1932).⁵ Where each of the separate writings has been subscribed by the party to be charged, little if any difficulty is encountered. Where, however, some writings have been signed, and others have not—as in the case before us—there is basic disagreement as to what constitutes a sufficient connection permitting the unsigned papers to be considered as part of the statutory memorandum. The courts of some jurisdictions insist that there be a reference, of varying degrees of specificity, in the signed writing to that unsigned, and, if there is no such reference, they refuse to permit consideration of the latter in determining whether the memorandum satisfies the statute. *See, e.g., Osborn v. Phelps*, 19 Conn. 63 (1848) ; *Hewitt Grain & Provision Co. v. Spear*, 193 N.W. 291 (Mich. 1923). That conclusion is based upon a construction of the statute which requires that the connection between the writings and defendant’s acknowledgment of the one not subscribed, appear from examination of the papers alone, without the aid of parol evidence. The other position—which has gained

⁵ [This reference is to the First Restatement of Contracts. You can (and should) locate the rules on what constitutes a sufficient memorandum to satisfy the statute of frauds in the Restatement (Second) of Contracts §§ 131-137. Section 132 is the one that specifically addresses the point raised here by the court— Eds.]

increasing support over the years—is that a sufficient connection between the papers is established simply by a reference in them to the same subject matter or transaction. *See, e.g., Frost v. Alward*, 169 P. 379 (Cal. 1917); *Lerned v. Wannemacher*, 91 Mass. 412. (1864). The statute is not pressed “to the extreme of a literal and rigid logic,” *Marks v. Cowdin, supra*, and oral testimony is admitted to show the connection between the documents and to establish the acquiescence, of the party to be charged, to the contents of the one unsigned. *See Beckwith v. Talbot*, 95 U.S. 289 (1877).

The view last expressed impresses us as the more sound, and, indeed—although several of our cases appear to have gone the other way, *see, e.g., Newbery v. Wall*, 65 N.Y. 484 (1875); *Wilson v. Lewiston Mill Co.*, 44 N.E. 959 (N.Y. 1896)—this court has on a number of occasions approved the rule, and we now definitively adopt it, permitting the signed and unsigned writings to be read together, provided that they clearly refer to the same subject matter or transaction. *See, e.g., Peabody v. Speyers*, 56 N.Y. 230 (1874); *Raubitschek v. Blank*, 80 N.Y. 478 (1880); *Peck v. Vandemark*, 1 N.E. 41 (N.Y. 1885); *Coe v. Tough*, 22 N.E. 550 (N.Y. 1889); *Delaware Mills v. Carpenter Bros.*, 139 N.E. 725 (N.Y. 1923).

The language of the statute—“Every agreement * * * is void, unless * * * some note or memorandum thereof be in writing, and subscribed by the party to be charged”—does not impose the requirement that the signed acknowledgment of the contract must appear from the writings alone, unaided by oral testimony. The danger of fraud and perjury, generally attendant upon the admission of parol evidence, is at a minimum in a case such as this. None of the terms of the contract are supplied by parol. All of them must be set out in the various writings presented to the court, and at least one writing, the one establishing a contractual relationship between the parties, must bear the signature of the party to be charged, while the unsigned document must on its face refer to the same transaction as that set forth in the one that was signed. Parol evidence—to portray the circumstances surrounding the making of the memorandum—serves only to connect the separate documents and to show that there was assent, by the party to be charged, to the contents of the one unsigned. If that testimony does not convincingly connect the papers, or does not show assent to the unsigned paper, it is within the province of the judge to conclude, as a matter of law, that the statute has not been satisfied. True, the possibility still remains that, by fraud or perjury, an agreement never in fact made may occasionally be enforced under the subject matter or transaction test. It is better to run that risk, though, than to deny enforcement to all agreements, merely because the signed document made no specific mention of the unsigned writing. As the United States Supreme Court declared, in sanctioning the admission of parol evidence to establish the connection between the signed and unsigned writings.

There may be cases in which it would be a violation of reason and common sense to ignore a reference which derives its significance from such [parol] proof. If there is ground for any doubt in the matter, the

general rule should be enforced. But where there is no ground for doubt, its enforcement would aid, instead of discouraging, fraud.

Beckwith v. Talbot, supra.

Turning to the writings in the case before us—the unsigned office memo, the payroll change form initialed by the general manager Johns, and the paper signed by the comptroller Carstens—it is apparent, and most patently, that all three refer on their face to the same transaction. The parties, the position to be filled by plaintiff, the salary to be paid him, are all identically set forth; it is hardly possible that such detailed information could refer to another or a different agreement. Even more, the card signed by Carstens notes that it was prepared for the purpose of a “Salary increase per contractual arrangements with Miss Arden.” That certainly constitutes a reference of sorts to a more comprehensive “arrangement,” and parol is permissible to furnish the explanation.

The corroborative evidence of defendant’s assent to the contents of the unsigned office memorandum is also convincing. Prepared by defendant’s agent, Miss Arden’s personal secretary, there is little likelihood that that paper was fraudulently manufactured or that defendant had not assented to its contents. Furthermore, the evidence as to the conduct of the parties at the time it was prepared persuasively demonstrates defendant’s assent to its terms. Under such circumstances, the courts below were fully justified in finding that the three papers constituted the “memorandum” of their agreement within the meaning of the statute.

The judgment should be affirmed, with costs.

Review Question 4. Assume the same facts as in *Crabtree v. Elizabeth Arden Sales Corp.* except that Crabtree decided at the six-month mark he did not like working for Elizabeth Arden, so he quit to join a competitor. Elizabeth Arden then sued to prevent him from leaving and to get damages for his breach of the two-year contract. What result in that case? Consider section 135 of the Restatement (Second) of Contracts in connection with your answer.

STEVENS v. PUBLICIS S.A.

Supreme Court of New York, Appellate Division, First Department
50 A.D.3d 253, 854 N.Y.S.2d 690 (Sup. Ct. App. Div. 2008)

LIPPMAN, P.J., TOM, WILLIAMS, and ACOSTA, JJ.

In October 1999, plaintiff sold his New York-based public relations firm, Lobsenz-Stevens (L-S), to defendant Publicis S.A., a French global communications company. The sale involved two contracts: a stock purchase agreement, pursuant to which plaintiff sold all the stock of L-S to defendants, and an employment agreement, pursuant to which plaintiff was to continue as chairman and CEO of the new company, named Publicis-Dialog, Public Relations, New York (PDNY), for three years. Plaintiff's duties were to be the "customary duties of a Chief Executive Officer."

Under the stock purchase agreement (SPA), plaintiff received an initial payment of \$3,044,000, and stood to earn "earn-out" payments of up to \$4 million contingent upon PDNY achieving certain levels of earnings before interest and taxes during the three calendar years after closing.

Within six months of the acquisition, signs of financial problems appeared. Plaintiff admits that revenue and profit targets were not met. Further, PDNY lost L-S's largest preacquisition client, Pitney Bowes. On March 5, 2001, plaintiff had a meeting with Jon Johnson, former CEO of Publicis Dialog, a related entity, at which he was shown financial statements and told that the business had lost approximately \$900,000 in the year 2000. Plaintiff was removed as CEO of the business, and was given several options, including leaving the firm, staying and working on new business, and a third option to come up with another alternative. Thereafter, Bob Bloom, former chairman and CEO of Publicis USA, became involved in the matter. Bloom and plaintiff exchanged a series of e-mails, culminating in a March 28 message from Bloom setting forth his understanding of the parties' terms regarding plaintiff's new role at PDNY:

Thus I suggested an allocation of your time that would permit the majority of your effort to go against new business development (70%). I also suggested that the remaining time be allocated to maintaining/growing the former Lobsenz Stevens clients (20%) and involvement in management/operations of the unit (10%). *This option, it would seem, is in your best interest because it offers the best opportunity for you to achieve your stated goal of a full earn-out.* When I suggested this option, you seemed to have considerable enthusiasm for it and expressed your satisfaction with it so I, of course, assumed that it was an option you preferred."

(Emphasis added.) By e-mail the next day, plaintiff wrote:

Bob, to begin with, I want to thank you again for helping me restore the dignity and respect that I'm entitled to as a senior professional. Things were really getting out of hand until you intervened.

What's happened since the lunch you and I had has been almost cathartic

That being said, I accept your proposal with total enthusiasm and excitement

I'm psyched again and will do everything in my power to generate business, maintain profits, work well with others and move forward.

(Emphasis added.)

Bloom replied the same day: "I am thrilled with your decision. You have my personal assurance that all of us will continue to work in the spirit of partnership to achieve our mutual goal and function together as close senior collaborators in a climate of respect and dignity for all." Each of the e-mail transmissions bore the typed name of the sender at the foot of the message.

In denying plaintiff's motion for partial summary judgment prior to trial, the court found that the parties had agreed in writing to modify plaintiff's duties under the employment agreement. In so ruling, the court properly relied on the e-mail exchange between the parties in which both sides expressed their unqualified acceptance of the modification to the agreement.

The series of e-mails beginning with Bloom's March 26, 2001 message setting forth the terms of the proposed modification, together with plaintiff's March 29 acceptance of the terms of the agreement and Bloom's immediate reply, memorialized the terms of the parties' agreement to change plaintiff's responsibilities under the employment agreement. The agreement is further confirmed in another e-mail sent to Andrew Hopson, chief operating officer of PDNY, in which plaintiff reaffirmed his unconditional acceptance of the modified agreement.

The e-mails from plaintiff constitute "signed writings" within the meaning of the statute of frauds, since plaintiff's name at the end of his e-mail signified his intent to authenticate the contents. Similarly, Bloom's name at the end of his e-mail constituted a "signed writing" and satisfied the requirement of section 13(d) of the employment agreement that any modification be signed by all parties.

Review Question 5. In many respects, the expanded view of "signed writings" reflected in *Stevens* seems like an appropriate accommodation of the law to changes in technology and business practices. On the other hand, given the ease with which a "signed writing" can be generated under the *Stevens* approach, can you foresee any downsides?

Review Question 6. Is there potential for the *Stevens* case to come out differently if it were decided under UETA, the Uniform Electronic Transactions Act,

excerpted from its Tennessee version below? Specifically, what arguments might you raise if you represented Publicis and wanted to prove a statute of frauds defense?

*UNIFORM ELECTRONIC TRANSACTIONS ACT
TENNESSEE CODE ANNOTATED*

§ 47-10-102. Definitions.

(4) “**Contract**” means the total legal obligation resulting from the parties' agreement as affected by this chapter and other applicable law.

(5) “**Electronic**” means relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.

* * *

(7) “**Electronic record**” means a record created, generated, sent, communicated, received, or stored by electronic means.

(8) “**Electronic signature**” means an electronic sound, symbol, or process attached to or logically associated with a record and executed or adopted by a person with the intent to sign the record.

§ 47-10-107. Legal recognition of electronic records, electronic signatures, and electronic contracts.

(a) A record or signature may not be denied legal effect or enforceability solely because it is in electronic form.

(b) A contract may not be denied legal effect or enforceability solely because an electronic record was used in its formation.

(c) If a law requires a record to be in writing, an electronic record satisfies the law.

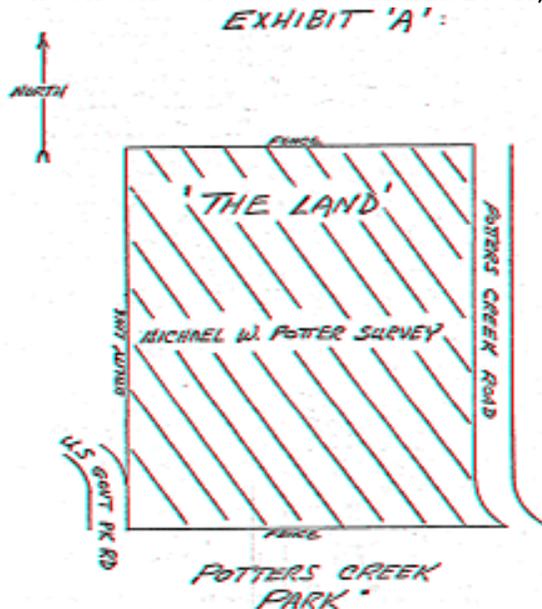
(d) If a law requires a signature, an electronic signature satisfies the law.

GUENTHER v. AMER-TEX CONSTRUCTION CO.
Court of Civil Appeals of Texas, Third District, Austin
534 S.W.2d 396 (Tex. App.—Austin 1976)

SHANNON, J.

Appellee, Amer-Tex Construction Company, filed suit in the district court of Comal County against Rosalie M. McClure for specific performance of a contract to convey land. Before trial, Rosalie M. McClure died, and the independent executor of her estate, Jack Guenther, was made defendant. After trial to the court, the district court entered judgment for specific performance. The contract to convey contained the following description of the land:

Reference is made to that certain tract of land adjoining Potter's Creek Park at Canyon Lake in Comal County, Texas, as shown on the attached Exhibit A, herein called "the land."



Appellant's principal contention is that the contract to convey did not describe the land with sufficient certainty to meet the requirements of the Statute of Frauds. Tex. Bus. & Comm. Code § 26.01 (1968).⁶

To comply with the requirements of the Statute of Frauds, the writing must furnish within itself, or by reference to some other existing writing, the means or data

⁶ [We have quoted the Texas statute immediately in these materials following this case.—Eds.]

by which the land to be conveyed may be identified with reasonable certainty. *Morrow v. Shotwell*, 477 S.W.2d 538 (Tex. 1972).

We are of the opinion that the contract to convey did not furnish within itself, or by reference to some other existing writing, the means or data by which the land to be conveyed could be identified with reasonable certainty. The only description of the land, other than that the land adjoined “Potter’s Creek Park at Canyon Lake in Comal County, Texas,” consisted of “Exhibit A,” a sketch or map not drawn to scale. The map did not show the width or length of the boundary lines, nor was there any indication that the boundary lines were to be parallel. The map did not show the approximate size of the tract or the number of acres contained therein. There was no recitation in the contract that Rosalie M. McClure owned or resided on the property. There was no reference in the contract to recorded deeds or other instruments from which the land might be identified.

Appellant argues that a “reasonable” man could take the map and locate the land on the ground. We are unable to agree. Most probably one could locate the fence at the corner of Potter’s Creek Road and Potter’s Creek Park. It would probably be possible to trace the fence westward to the “US Govt Pk Rd.” At or about the “US Gvt Pk Rd” there is shown some kind of utility line, perhaps an electric line, a telephone line, or a gas pipeline. If one could find the utility line, one is supposed to follow that line north for an undetermined distance to a “fence” which runs in an easterly direction. We conclude that from an examination of the map only the southeastern corner of the tract at Potter’s Creek Road and Potter’s Creek Park could be established with any reasonable certainty.

Doubtless the parties to the contract to convey knew and understood what land was intended to be conveyed. Moreover, two of appellee’s witnesses testified that sometime after the contract was signed a surveyor located the land and made a metes and bounds description thereof. However, the knowledge and intent of the parties will not give validity to the contract, and neither will a plat made up from extrinsic evidence. *Matney v. Odom*, 210 S.W.2d 980 (Tex. 1948).

The judgment is reversed and judgment is here rendered that appellee take nothing.

TEXAS BUSINESS & COMMERCE CODE

§ 26.01. Promise or Agreement Must Be In Writing

(a) A promise or agreement described in Subsection (b) of this section is not enforceable unless the promise or agreement, or a memorandum of it, is

(1) in writing; and

(2) signed by the person to be charged with the promise or agreement or by someone lawfully authorized to sign for him.

(b) Subsection (a) of this section applies to:

(1) a promise by an executor or administrator to answer out of his own estate for any debt or damage due from his testator or intestate;

(2) a promise by one person to answer for the debt, default, or miscarriage of another person;

(3) an agreement made on consideration of marriage or on consideration of nonmarital conjugal cohabitation;

(4) a contract for the sale of real estate;

(5) a lease of real estate for a term longer than one year;

(6) an agreement which is not to be performed within one year from the date of making the agreement;

(7) a promise or agreement to pay a commission for the sale or purchase of:

(A) an oil or gas mining lease;

(B) an oil or gas royalty;

(C) minerals; or

(D) a mineral interest;

and

(8) an agreement, promise, contract, or warranty of cure relating to medical care or results thereof made by a physician or health care provider as defined in Section 74.001, Civil Practice and Remedies Code. This section shall not apply to pharmacists.

Review Question 6. “Doubtless the parties to the contract to convey knew” says the *Guenther* court, “and understood what land was intended to be conveyed.” A surveyor also located the land and made a complete metes-and-bounds description of its location. Given those facts, exactly what interests are being served by the court not enforcing this contract?

Problems

Problem 14.1

Seth is a student in the Master of Business Administration program at Elite University in California. Before graduation, he is offered a coveted high-paying job at the famous investment bank, Morgan Sacks & Co., in New York City. He also has several other offers at locations around the country. Ultimately he decides that the opportunity is best at Morgan, so he accepts the job on March 1. After graduating, he packs up his few belongings, flies to New York, rents a small apartment in the Tribeca area, and on July 1 he starts work. He never signs any written employment agreement with Morgan. Two months later, on September 1, he is fired for incompetence and insubordination. Seth sues, claiming that when he was being recruited he was orally promised that his initial contract term would be two years, and that he would not be fired within that time. Morgan responds by denying any such statements were made, that it has never made any such promises to any new employee, and it moves to dismiss because the alleged contract is not in writing. What result and why? Consider Restatement (Second) of Contracts § 139 in connection with this problem.

Problem 14.2

Lucy and Zehmer are sitting in the bar of the Zehmer's restaurant, the Olde Virginnie, in Kopperl, Texas. Lucy offers \$500,000 for a piece of property that Zehmer owns called the "Ferguson Farm." After negotiation, Zehmer handwrites the following on the back of one of his customer bar tab checks: "I agree to sell to W.O. Lucy the Ferguson Farm complete for \$500,000.00, title satisfactory to buyer." Beneath it he writes the date and signs his name, "A.H. Zehmer." Lucy leaves, taking the document with him. The next day Zehmer calls Lucy and says, "I changed my mind, I don't want to sell the farm." He refuses to convey the property or take Lucy's payment. Lucy sues.

Zehmer argues that the written memorandum does not satisfy the Statute of Frauds and thus the contract is unenforceable because it does not contain reasonably certain terms. Lucy has witnesses to testify that people in Bosque County, Texas, understand that "the Ferguson Farm" is a particular piece of property located at 1042 Route FM-56. That farm consists of 403 acres of land, on which are a small house, several outbuildings, livestock facilities, an irrigation system for the grass, two large tractors, and a herd of 200 purebred Charolais cattle.

Does the Texas Statute of Frauds (quoted immediately before the problems) prevent Lucy from enforcing the agreement?

Problem 14.3

Van der Rohe USA, Inc. (VRUSA) is the American division of a Dutch corporation, Van der Rohe N.V.⁷ VRUSA operates specialty female clothing stores under its “Le Corbusier” brand in shopping malls in the Northeastern United States. Its corporate offices are in White Plains, New York. VRUSA has a corporate email system. Per company policy, the system automatically attaches the name and contact information of the sender at the foot of every email that is sent. Employees cannot disable the system. The system automatically attaches a confidentiality and privacy notice at the bottom that employees also cannot remove.

Les Ismore is a real estate professional in the VRUSA home office, responsible for negotiating shopping mall leases for VRUSA. Les is in negotiations with Onondaga Mills LLC, the operator of a major upscale shopping mall near Syracuse, New York, for a 10-year-lease. Les and his counterpart at Onondaga, Alice Sells, have been exchanging communications and draft agreements for about a month. On June 1, Alice sends Les a revised “Lease Agreement” that incorporates the results of their various discussions. The lease is 19 pages long and very detailed. It has blocks for the signatures of Alice and Les as authorized representatives of their respective companies. Alice sends an unsigned copy to Les as an email attachment. Her email reads:

From: Sells, Alice <asells@onondagamills.com>
Sent: Thursday, June 1, 20XX 9:32 AM
To: Ismore, Les
Cc: Vark, Jonah
Subject: OM Lease 24-451 Le Corbusier

Hi, Les. Attached is the final agreement we reached. It incorporates all the stuff we talked about. I am glad we could work out all the details and delighted Corbusier is going to be part of our outstanding lineup of stores at OM. It’s been a pleasure working with you. I am copying Jonah, the OM operations manager so he can start the process of getting you in. Thanks again.

Alice

Sent from my eFone by my personal assistant, Mari

An hour later Les sends the following response, reprinted in its entirety:

From: Ismore, Les <les.ismore@vrusa.com>
Sent: Thursday, June 1, 20XX 10:44 AM
To: Sells, Alice

⁷ [Abbreviation for *Naamloze vennootschap*—roughly “anonymous partnership”—the Netherlands equivalent of an American publicly held corporation. – Eds.]

Cc:
Subject: Re: OM Lease 24-451 Le Corbusier
Looks good. Glad we have a contract, great to be in Syracuse. Will be back in touch ASAP.

Lester W. Ismore, Jr.
Van der Rohe USA, Inc.
192 Bloomingdale Road
Suite 1200
White Plains, NY 10605
O: 914-555-3091
F: 914-555-3008
les.ismore@vrusa.com

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VRUSA never actually signs the contract. Three weeks later, not having responded to Alice despite several attempts by her to contact Les, the company decides it does not want to enter the Syracuse market at Onondaga Mills, and refuses to go forward. Les notifies Alice that the deal is off. Onondaga Mills, meanwhile, had turned down an offer by another clothing store, Aéropostale, Inc., for the same space, which is now going to be vacant. It has also had its employees begin getting the space cleared away for the renovations Le Corbusier will need for its store, although no work has been started to date.

Onondaga Mills sues VRUSA, claiming VRUSA is in breach of the contract. Are the New York statutes of frauds quoted below a bar to Onodaga Mills enforcing the agreement?

NEW YORK GENERAL OBLIGATIONS LAW

§ 5-701. Agreements required to be in writing

a. Every agreement, promise or undertaking is void, unless it or some note or memorandum thereof be in writing, and subscribed by the party to be charged therewith, or by his lawful agent, if such agreement, promise or undertaking:

1. By its terms is not to be performed within one year from the making thereof or the performance of which is not to be completed before the end of a lifetime;
2. Is a special promise to answer for the debt, default or miscarriage of another person;
3. Is made in consideration of marriage, except mutual promises to marry;
4. [Repealed]
5. Is a subsequent or new promise to pay a debt discharged in bankruptcy;

6. . . . [I]f the goods be sold at public auction, and the auctioneer at the time of the sale, enters in a sale book, a memorandum specifying the nature and price of the property sold, the terms of the sale, the name of the purchaser, and the name of the person on whose account the sale was made, such memorandum is equivalent in effect to a note of the contract or sale, subscribed by the party to be charged therewith;

7. [Repealed]

8. [Repealed]

9. Is a contract to assign or an assignment, with or without consideration to the promisor, of a life or health or accident insurance policy, or a promise, with or without consideration to the promisor, to name a beneficiary of any such policy. This provision shall not apply to a policy of industrial life or health or accident insurance.

§ 5-703. Conveyances and contracts concerning real property required to be in writing

1. An estate or interest in real property . . . other than a lease for a term not exceeding one year . . . cannot be created . . . unless by . . . a deed or conveyance in writing, subscribed by the person creating . . . the same, or by his lawful agent, thereunto authorized by writing. . . .

2. A contract for the leasing for a longer period than one year, or for the sale, of any real property, or an interest therein, is void unless the contract or some note or memorandum thereof, expressing the consideration, is in writing, subscribed by the party to be charged, or by his lawful agent thereunto authorized by writing.

3. A contract to devise real property or establish a trust of real property, or any interest therein or right with reference thereto, is void unless the contract or some note or memorandum thereof is in writing and subscribed by the party to be charged therewith, or by his lawfully authorized agent.

4. Nothing contained in this section abridges the powers of courts of equity to compel the specific performance of agreements in cases of part performance.

Unit 15: Assent-Based Defenses

CONTRACT DEFENSES

Part Three

FOCUS OF THIS UNIT

Contract law exists largely to enforce voluntary transactions. As a result, when facts suggest that a transaction was not voluntary in some serious way, contract law provides for defenses to be raised against enforcement of the agreement. Reasons to attack a contract based on the lack of true assent include fraud or misrepresentation, a party's failure to disclose important facts, threats of violence, irresistible pressure, or even an honest mistake of fact. Just as the statute of frauds can prevent enforcement of an otherwise enforceable contract, so can these matters that we here label "assent-based defenses."

Fraud and Misrepresentation. You may have run across *fraud* in your Torts class because it is an intentional tort. In broad terms, fraud occurs when one party makes a false statement with the intent to mislead the other, and the other reasonably believes the statement and is damaged as a result. As a defense to enforcing a contract, fraud is easy to understand: a contract is *always* voidable by the defrauded party. More difficult questions arise when the false statement is not deliberate and *misrepresentation* occurs instead. Here, a party simply fails to disclose information that would be critical to the other party's decision.

Duress. The threat of force or other unlawful action to induce a party to consent is called *duress*. Consider the scene in the *Godfather* movie, where a bandleader has refused to release singer Johnny Fontaine from his contract. Don Vito successfully obtains the bandleader's assent with "an offer he couldn't refuse," namely, having a gun held to his head and telling him that either "his brains or his signature" will be on the contract release. The "gun to the head" fact pattern is the classic (and easy) example case of duress, but pressure that is much less than that can also render a contract voidable for duress. Just how much is enough?

Undue Influence. Somewhat related to duress is the concept of *undue influence*. Improper pressure to enter a contract is sometimes not the result of direct threats. Instead, an overwhelming influence by a more powerful party is overriding the judgment of a vulnerable party. In a claim of undue influence, lawyers call these the "dominant" and "servient" parties. Undue influence most typically occurs in two

broad categories. The first is the one in which a party in a position of trust—*e.g.*, lawyers, physicians, trustees, guardians, and so on, often called “fiduciaries”—abuses a “confidential relationship” to steer the trusting other party into bad deals, including deals that personally benefit the fiduciary. The less-sophisticated party was harmed because he reasonably relied on the fiduciary’s advice. The second situation is when a party who is not actually a fiduciary has developed a position of dominance over another and effectively imposes his will on the other party. A typical situation involves a family member, neighbor, or servant who so insinuates himself into the life of an elderly and often incapacitated person, and then exploits that position to obtain gifts or promises to rewrite a will. While this is perhaps the most common category of undue influence, the doctrine can be used in a wide range of situations.

Mistake. Yet another ground for voiding contracts is *mistake*. In most agreements, each party knows at some level that her knowledge is incomplete. The parties do not necessarily know everything about the current situation of the world, and they know even less about the future. Almost by definition, a party who signs a contract that turns out to be a bad deal was “mistaken” in some sense. The old toy we sell at a yard sale may turn out to be an incredibly valuable “Sheriff Woody” action figure. The stock we buy with every expectation that it will go up suddenly drops like a rock. One popular television show features auction attendees who are given only minutes to appraise a storage locker full of flotsam for five minutes and then bid on it. The excitement comes from knowing that there may be nothing but trash, but that there may also be a lost Rembrandt drawing worth millions. This uncertainty is involved in a large number of contracts—even buying gasoline for your car today involves taking a gamble, because the price tomorrow might be much less or much more. Being wrong about the normal uncertainties of life does not establish the defense of mistake.

Some mistakes, in contrast, are so fundamental to the nature of the deal that the law will allow the contract to be avoided. An obvious and uncontroversial example would be a contract to build and install a swimming pool where both parties assume that the yard consists only of dirt that can be excavated cheaply. If, in fact, a massive granite boulder six inches below the surface requires costly blasting, or if the area turns out to be a major archaeological site or to contain dozens of buried and extremely hazardous World War I chemical weapons that require hundreds of thousands of dollars to remove, the doctrine of mistake would protect the pool installers from extraordinary costs that neither party anticipated. Unsurprisingly, the difficult question with the doctrine of mistake is determining which mistakes are so fundamental that they will allow avoidance of the contract, and which mistakes are ones where a party simply came out on the bad side of the contract’s allocation of risk.

As you read this unit, you may find it helpful to review the Restatement provisions on fraud and misrepresentation (§§ 159-164), duress and undue influence (§§ 174-177) and mistake (§§ 151-154).

Cases and Materials

ALABI v. DHL AIRWAYS, INC.
Superior Court of Delaware, New Castle
583 A.2d 1358 (Del. Super. 1990)

HERLIHY, J.

[DHL was an express package delivery service. In Philadelphia, Mabayomije Alabi—who had regularly used DHL’s services for more than two years—allegedly put \$15,000 in cash in a DHL envelope to be sent to London. DHL required customers to generally describe the contents of envelopes in a box on the shipping contract. Because DHL’s terms and conditions prohibited accepting or shipping cash, Alabi wrote “documents relating to school bills” in the box, and sealed the package before handing it over to DHL, which was otherwise unaware of its contents. Alabi was required to certify that “the article in the shipment is properly described and is not an item “which DHL has declared to be unacceptable” for shipment. Alabi inquired if the package could be insured for \$15,000; DHL said that its maximum insurance value was \$10,000. Alabi paid \$76 for shipment and for the \$10,000 in insurance. When the envelope arrived in London, it disappeared from the DHL storage area. Police were called in, but the package and its contents were never found. Alabi claimed that DHL was negligent, and demanded the \$15,000, plus punitive damages.]

DHL seeks summary judgment claiming plaintiff’s contracts with it are voidable due to his alleged misrepresentation of the contents of the envelope. A contract may be voidable on the basis of misrepresentation, be it a fraudulent or an innocent misrepresentation. *Norton v. Poplos*, 443 A.2d 1 (Del. Super. 1982); Restatement (Second) of Contracts § 164. As such, misrepresentation can be asserted as an affirmative defense to an action on the contract.

The Restatement (Second) of Contracts provides probably the clearest discussion of the elements that need be shown to prevail when asserting misrepresentation as a defense. In order for a contract to be voidable, a party must show all four of the following elements: (1) that there was a misrepresentation; (2) that the misrepresentation was either fraudulent or material; (3) that the misrepresentation induced the recipient to enter into the contract; and (4) that the recipient’s reliance on the misrepresentation was reasonable. Rest. 2d § 164.

The first issue is whether the labeling of the envelope, allegedly containing \$15,000 in cash, as “documents regarding school bills” constitutes a

misrepresentation. A misrepresentation is “an assertion that is not in accordance with the facts.” Plaintiff asserts that “documents” suffices as a general description of currency. This is an untenable position. The term “documents regarding school bills” does not indicate that the contents are inherently valuable to third-party interlopers or others in DHL’s position. Plaintiff’s description is not in accord with the now alleged fact that there was cash in the envelope and, consequently, is a misrepresentation of the contents.

The second element is whether the misrepresentation was fraudulent or material. If the misrepresentation was non-fraudulent or innocent, it must be material for the contract to be voidable. Rest. 2d § 164 cmt b. On the other hand, if the misrepresentation was fraudulent, it is not required to be material for the contract to be voidable.

(1) A misrepresentation is fraudulent if the maker intends his assertion to induce a party to manifest his assent and the maker

(a) knows or believes that the assertion is not in accord with the facts, or

(b) does not have the confidence that he states or implies in the truth of the assertion, or

(c) knows that he does not have the basis that he states or implies for the assertion.

Rest. 2d § 162. The plaintiff claims that the description was as accurate as he felt it could be without inviting theft. By making such an assertion, to some extent plaintiff purposely misled DHL about the contents of the shipment. However, plaintiff also claims that he was unaware that DHL would not ship cash. In considering the requirement to view the record in a light most favorable to the non-moving party, the Court is simply unwilling at this point to rule that the misrepresentation was fraudulent as a matter of law.

The alternative factor to be considered under the second element is, if the misrepresentation is not fraudulent, is it, nevertheless, material.

(2) A misrepresentation is material if it would be likely to induce a reasonable person to manifest his assent, or if the maker knows that it would be likely to induce the recipient to do so.

Rest. 2d § 162. “The materiality of a misrepresentation is determined from the viewpoint of the maker.” *Id.* cmt c.

In the instant case, plaintiff had in his possession airbills which are bills of lading. Based on this long-time use of DHL’s services, plaintiff cannot now be heard to complain that he was unaware of the terms and conditions contained on the Airway

bill. Therefore, plaintiff is bound by those terms and conditions, as he signed the Airway bill.

Given that plaintiff must be charged with the knowledge that DHL does not accept cash for delivery, the misrepresentation becomes material. It is material because “the maker [plaintiff] knows that for some special reason it is likely to induce the particular recipient to manifest his assent.” Rest. 2d § 162 cmt c. Put simply, the plaintiff had reason to know DHL would not accept cash and describing the shipment as otherwise, he induced DHL to enter into a contract to which it would not otherwise assent to.

The third element to be considered is whether the misrepresentation induced DHL to enter into the contract. “A misrepresentation induces a party’s manifestation of assent if it substantially contributes to his decision to manifest his assent.” Rest. 2d § 167. It is not necessary that this party’s reliance on the misrepresentation be “the sole or even the predominant factor in influencing his conduct.” *Id.* cmt a. “It is assumed, in absence of facts showing the contrary, that the recipient attached importance to the truth of the misrepresentation if it was material, but not if it was immaterial.” *Id.* cmt b.

In the instant case, the misrepresentation was material. Further, there is nothing in the record to indicate that DHL did not attach importance to the misrepresentation. In fact, it is just the opposite. As noted before, the shipper’s¹ signature block of the Airway bill contains the following statement, “I warrant that all details given herein are true and correct,” plus paragraph 2 on the back of the bill, relating to giving an accurate description of the contents, reflects DHL’s concern as to the accuracy of the description of the shipment, as does the blank the shipper uses to describe the contents. Therefore, it is clear that the misrepresentation was a substantial factor in DHL’s decision to enter into the contracts at issue.

The fourth element to be considered is whether DHL’s reliance on the misrepresentation is reasonable. A misrepresentation will have no legal effect unless the recipient’s reliance is justified. Prior to shipping and giving the envelope to DHL, plaintiff twice inquired as to the availability of \$15,000 worth of insurance. This would indicate that the documents’ value belied the description on the Airway bill. DHL argues that plaintiff attempts to impose a duty to inspect every envelope.

This may or may not be plaintiff’s intent but that is of no moment. What is important is the fact that DHL does reserve the right to inspect the envelopes it accepts for delivery. DHL would not reserve such a right if it did not believe that at some point or on some occasion it would want to check the contents because it has reason to believe the description is inaccurate. DHL realizes that it is not always

¹ [Be careful with the terminology here, as it sometimes confuses students. In a transportation contract, the “carrier” is the entity that transports the goods (in this case, DHL), and the “shipper” is the person (Alabi) who has delivered the goods to the carrier for shipment.—Eds.]

reasonable to rely on the description supplied by a shipper. Where that point or occasion falls is a question of fact that should be left to the trier of fact. Therefore, the Court finds that a material issue of fact exists as to the reasonableness of DHL's reliance on the description supplied by plaintiff.

Since all four elements have not been established as a matter of law, granting summary judgment would not be proper.

Review Question 1. At one point in the opinion (discussing whether the representation was “fraudulent”) the court says that it cannot say that Alabi knew that DHL would not accept cash for shipment. At another point (discussing “materiality”) the court says that we have to assume that Alabi knew that DHL would not accept cash. Why the difference?

STANDARD FINANCE CO. v. ELLIS

Intermediate Court of Appeals of Hawaii
3 Haw. App. 614, 657 P.2d 1056 (Haw. Ct. App. 1983)

TANAKA, J.

In an action on a promissory note, defendant Betty Ellis appeals from the summary judgment in favor of plaintiff Standard Finance Company, Limited.

The only issue is whether the granting of summary judgment was proper. We hold that it was and affirm.

The record shows that on September 30, 1976, defendant and her then husband W. G. Ellis (hereinafter “Ellis”), executed and delivered to plaintiff a promissory note in the amount of \$2,800. Nothing having been paid on the note, plaintiff filed a collection suit on May 15, 1980.² On January 15, 1981, the trial court entered its order granting plaintiff's motion for summary judgment. On March 9, 1981, judgment in the amount of \$5,413.35 was filed. Defendant's timely appeal followed.

² [By the court] Ellis was not named a party defendant in the case. Defendant states that shortly after the execution and delivery of the note, Ellis filed for and was declared a bankrupt.

On appeal, defendant claims that plaintiff was not entitled to summary judgment because there were genuine issues of material fact as to whether duress was involved in obtaining defendant's signature. We disagree.

In her answers to interrogatories, defendant states that she was "forced" to sign the note under duress. "[P]hysical beatings" of and "psychological pressure" on her by Ellis "[f]or at least the 3 yrs. prior to signing of note" constituted the duress. She argues that her execution of the note which was compelled by duress was not a manifestation of her assent. Thus, the note is void and unenforceable.

The law concerning duress resulting in void or voidable contracts is discussed in Restatement (Second) of Contracts §§ 174 and 175(1) (1981). Section 174 reads:

If conduct that appears to be a manifestation of assent by a party who does not intend to engage in that conduct is physically compelled by duress, the conduct is not effective as a manifestation of assent.

Comment a to § 174 provides in part:

This Section involves an application of that principle to those relatively rare situations in which actual physical force has been used to compel a party to appear to assent to a contract. . . . The essence of this type of duress is that a party is compelled by physical force to do an act that he has no intention of doing. He is, it is sometimes said, "a mere mechanical instrument." The result is that there is no contract at all, or a "void contract" as distinguished from a voidable one.

Section 175(1) states:

If a party's manifestation of assent is induced by an improper threat by the other party that leaves the victim no reasonable alternative, the contract is voidable by the victim.

We hold that as a matter of law the facts in the record do not constitute the type of duress which renders the note void under § 174. Such duress involves the use of actual physical force to compel a person to sign a document. It may include the example given in comment 6 to [Uniform Commercial Code] § 3-305 of an "instrument signed at the point of a gun" being void.

Here, the only evidence of duress is "physical beatings" and "psychological pressure" by Ellis on defendant over a course of three years prior to defendant's signing of the note. Without more, such evidence does not constitute § 174 duress resulting in the voiding of the note. From such evidence it cannot reasonably be inferred that the physical beatings by Ellis directly resulted in defendant signing the note in question.

As a matter of law, based on the facts in the record, the note was not voidable by defendant under § 175(1).

Defendant relies heavily on *Furnish v. Commissioner of Internal Revenue*, 262 F.2d 727 (9th Cir. 1958). In *Furnish*, a wife had signed blank income tax forms at the request of her husband. The court of appeals reversed the judgment imposing a deficiency against the wife and remanded the case for a determination of duress stating that it is “harshly inequitable for the wife to be forced to pay a penalty for fraud arising out of nothing she had done, save signing a blank return required of her by a dominating husband.”

Furnish is distinguishable from this case. There duress was discussed in regards to its validity as a defense to a tax liability created by 26 U.S.C. § 51(b) (1939). Here, under the Uniform Commercial Code, comment 6 to § 3-305 states in part, “They [duress and illegality] are primarily a matter of local concern and local policy. All such matters are therefore left to the local law.” Hawaii has adopted the Restatement’s definition of duress that “where a party’s manifestation of assent is induced by an improper threat that leaves him no reasonable alternative, the contract is voidable by that party.” *Penn v. Transportation Lease Hawaii, Ltd.*, 630 P.2d 646, 649 (Haw. Ct. App. 1981).

Plaintiff did not threaten defendant. In his affidavit, Ron Higa makes the following uncontradicted statement:

At no time prior to or contemporaneously with the execution of said note did Defendant Ellis state or indicate in any manner that she was acting under coercion or duress in the execution of said note.

Thus, contrary to defendant’s contention, no genuine issue of material fact existed. The facts and their inferences viewed in the light most favorable to defendant do not constitute valid defenses to the action, and summary judgment was properly granted.

Affirmed.

Review Question 2. How can the *Standard Finance* court determine that there was *not* a “genuine issue of material fact” whether Betty was really free to make a voluntary decision while under the influence of an abusive husband. The court seems to say that even if we assume she was, she is liable on her contracts. How exactly does the law allow for such a result?

Review Question 3: The opinion discusses *Furnish*, a 1958 case where the wife won, while in *Standard Finance* the 1983 wife loses. The latter case even involves physical beatings. The court explains the difference as a distinction between federal law and one state law. Perhaps. Can you think of any reasons why a 1983 court would

be less likely to excuse a wife who was “dominated” by her husband than a 1958 court would have. Can you think of any reasons why a court today might approach the situation differently yet again?

AUSTIN INSTRUMENT, INC. v. LORAL CORP.

Court of Appeals of New York
29 N.Y.2d 124, 272 N.E.2d 533, 324 N.Y.S.2d 22 (1971)

FULD, C.J.:

[In 1965, Loral Corp. won a \$6,000,000 from the Navy to produce radar sets for use in the then-escalating Vietnam War. The contract contained a schedule of deliveries and allowed the Navy to penalize Loral or cancel the contract if there were delays or failures to deliver. Loral signed a contract with Austin Instruments to make 23 of the 40 precision gear components needed for the radar set. (The contracts were awarded to the low bidders on each individual component. The remainder went to other subcontractors.) The subcontract turned out to be unprofitable for Austin. In May, 1966, Loral was awarded a second Navy contract for the production of more radar sets, and again sought bids on the components. Austin bid on all 40, but was told it would be awarded contracts only on those items on which it was low bidder. Austin threatened to stop delivering components under the 1965 contract unless Loral agreed to (a) award it all of the components on the 1966 contract whether it was low bidder or not, and (b) retroactively increase the price on the items already delivered under the 1965 contract. Loral “feverishly” contacted all other available suppliers but because of war requirements they were all unable to promise delivery on the time scheduled demanded by the Navy. Loral therefore agreed to Austin’s demands. Loral finished the radar sets and delivered them to the Navy, but then informed Austin that it would seek to recover the extra amounts paid to Austin. It also withheld payment under the 1966 contract after deliveries were made. Austin sued, seeking \$17,750 allegedly due under the 1966 contract; the same day, Loral sued, seeking \$22,250 for extra payments under the 1965 contract.]

The applicable law is clear and, indeed, is not disputed by the parties. A contract is voidable on the ground of duress when it is established that the party making the claim was forced to agree to it by means of a wrongful threat precluding the exercise of his free will. *See Allstate Medical Laboratories v. Blaiwas*, 229 N.E.2d 50 (N.Y. 1967). The existence of economic duress or business compulsion is demonstrated by proof that “immediate possession of needful goods is threatened” *Mercury Machine Importing Corp. v. City of New York*, 144 N.E.2d 400 (N.Y. 1957), or, more particularly, in cases such as the one before us, by proof that one party to a contract has threatened to breach the agreement by withholding goods unless the

other party agrees to some further demand. *See, e.g., E.I. du Pont de Nemours & Co. v. Hass Co.*, 103 N.E.2d 896 (N.Y. 1954). However, a mere threat by one party to breach the contract by not delivering the required items, though wrongful, does not in itself constitute economic duress. It must also appear that the threatened party could not obtain the goods from another source of supply and that the ordinary remedy of an action for breach of contract would not be adequate.

It is manifest that Austin's threat to stop deliveries unless the prices were increased deprived Loral of its free will. As bearing on this, Loral's relationship with the Government is most significant. As mentioned above, its contract called for staggered monthly deliveries of the radar sets, with clauses calling for liquidated damages and possible cancellation on default. Because of its production schedule, Loral was, in July, 1966, concerned with meeting its delivery requirements in September, October and November, and it was for the sets to be delivered in those months that the withheld gears were needed. Loral had to plan ahead, and the substantial liquidated damages for which it would be liable, plus the threat of default, were genuine possibilities. Moreover, Loral did a substantial portion of its business with the Government, and it feared that a failure to deliver as agreed upon would jeopardize its chances for future contracts. These genuine concerns do not merit the label "self-imposed, undisclosed and subjective," which the Appellate Division majority placed upon them. It was perfectly reasonable for Loral, or any other party similarly placed, to consider itself in an emergency, duress situation.

We find unconvincing Austin's contention that Loral, in order to meet its burden, should have contacted the Government and asked for an extension of its delivery dates so as to enable it to purchase the parts from another vendor. Aside from the consideration that Loral was anxious to perform well in the Government's eyes, it could not be sure when it would obtain enough parts from a substitute vendor to meet its commitments. The only promise which it received from the companies it contacted was for commencement of deliveries, not full supply, and, with vendor delay common in this field, it would have been nearly impossible to know the length of the extension it should request. It must be remembered that Loral was producing a needed item of military hardware. Moreover, there is authority for Loral's position that nonperformance by a subcontractor is not an excuse for default in the main contract. *See, e.g., JOHN COSGROVE MCBRIDE & ISIDORE H. WACHTEL, GOVERNMENT CONTRACTS* § 35.10 (1962). In light of all this, Loral's claim should not be held insufficiently supported because it did not request an extension from the Government.

Loral, as indicated above, also had the burden of demonstrating that it could not obtain the parts elsewhere within a reasonable time, and there can be no doubt that it met this burden. The 10 manufacturers whom Loral contacted comprised its

entire list of “approved vendors” for precision gears,³ and none was able to commence delivery soon enough. As Loral was producing a highly sophisticated item of military machinery requiring parts made to the strictest engineering standards, it would be unreasonable to hold that Loral should have gone to other vendors, with whom it was either unfamiliar or dissatisfied, to procure the needed parts. Loral “contacted all the manufacturers whom it believed capable of making these parts,” and this was all the law requires.

It is hardly necessary to add that Loral’s normal legal remedy of accepting Austin’s breach of the contract and then suing for damages would have been inadequate under the circumstances, as Loral would still have had to obtain the gears elsewhere with all the concomitant consequences mentioned above. In other words, Loral actually had no choice, when the prices were raised by Austin, except to take the gears at the “coerced” prices and then sue to get the excess back.

Austin’s final argument is that Loral, even if it did enter into the contract under duress, lost any rights it had to a refund of money by waiting until July, 1967, long after the termination date of the contract, to disaffirm it. It is true that one who would recover moneys allegedly paid under duress must act promptly to make his claim known. *See Oregon Pacific R. R. Co. v. Forrest*, 28 N.E. 137 (N. Y. 1891). In this case, Loral delayed making its demand for a refund until three days after Austin’s last delivery on the second subcontract. Loral’s reason for waiting until that time is that it feared another stoppage of deliveries which would again put it in an untenable situation. Considering Austin’s conduct in the past, this was perfectly reasonable, as the possibility of an application by Austin of further business compulsion still existed until all of the parts were delivered.

In sum, the record before us demonstrates that Loral agreed to the price increases in consequence of the economic duress employed by Austin. Accordingly, the matter should be remanded to the trial court for a computation of its damages.

Review Question 4. Think back to the *Alaska Packers* case, in which changes to the fishermen’s contract were struck down for lack of consideration. Why did the court here not simply hold that there was no consideration for changes to the 1965 contract because Austin’s obligations under that contract did not change?

Review Question 5. Loral was a large, publicly held company that manufactured sophisticated electronic systems. The court says that Austin’s threat “deprived Loral of its free will.” In her article *Revisiting Austin v. Loral: A Study in*

³ [By the court] Loral, as do many manufacturers, maintains a list of approved vendors, that is, vendors whose products, facilities, techniques and performance have been inspected and found satisfactory.

Economic Duress, Contract Modification and Framing, 2 Hastings Bus. L.J. 357 (2006), Professor Meredith Miller argues that the focus on Loral's lack of choices is misplaced. The real issue should be whether or not Austin was acting in good faith—that is, whether it was trying to take advantage of Loral rather than merely trying to keep from losing a large amount of money on the contract. What do you think of that approach as compared to what the court says?

ODORIZZI v. BLOOMFIELD SCHOOL DISTRICT

Court of Appeal of California, Second Appellate District
246 Cal. App. 2d 123, 54 Cal. Rptr. 533 (2d Dist. 1966)

FLEMING, J.:

Appeal from a judgment dismissing plaintiff's amended complaint on demurrer.

Plaintiff Donald Odorizzi was employed during 1964 as an elementary school teacher by defendant Bloomfield School District and was under contract with the district to continue to teach school the following year as a permanent employee. On June 10 he was arrested on criminal charges of homosexual activity, and on June 11 he signed and delivered to his superiors his written resignation as a teacher, a resignation which the district accepted on June 13. In July the criminal charges against Odorizzi were dismissed under Cal. Penal Code § 995,⁴ and in September he sought to resume his employment with the district. On the district's refusal to reinstate him he filed suit for declaratory and other relief.

Odorizzi's amended complaint asserts his resignation was invalid because obtained through duress, fraud, mistake, and undue influence and given at a time when he lacked capacity to make a valid contract. Specifically, Odorizzi declares he was under such severe mental and emotional strain at the time he signed his resignation, having just completed the process of arrest, questioning by the police, booking, and release on bail, and having gone for 40 hours without sleep, that he was incapable of rational thought or action. While he was in this condition and unable to think clearly, the superintendent of the district and the principal of his school came to his apartment. They said they were trying to help him and had his best interests at heart, that he should take their advice and immediately resign his position with the district, that there was no time to consult an attorney, that if he did not resign immediately the district would suspend and dismiss him from his position and

⁴ [That is, dismissed for insufficient evidence.—Eds.]

publicize the proceedings, his “afore-described arrest” and cause him “to suffer extreme embarrassment and humiliation”; but that if he resigned at once the incident would not be publicized and would not jeopardize his chances of securing employment as a teacher elsewhere. Odorizzi pleads that because of his faith and confidence in their representations they were able to substitute their will and judgment in place of his own and thus obtain his signature to his purported resignation. A demurrer to his amended complaint was sustained without leave to amend.

By his complaint plaintiff in effect seeks to rescind his resignation pursuant to Civil Code, section 1689,⁵ on the ground that his consent had not been real or free within the meaning of Civil Code, section 1567,⁶ but had been obtained through duress, menace, fraud, undue influence, or mistake.

We agree with respondent’s contention that neither duress nor menace was involved in this case, because the action or threat in duress or menace must be unlawful, and a threat to take legal action is not unlawful unless the party making the threat knows the falsity of his claim.

Nor do we find a cause of action for fraud, either actual or constructive. Actual fraud involves conscious misrepresentation, or concealment, or non-disclosure of a material fact which induces the innocent party to enter the contract. While the amended complaint charged misrepresentation, it failed to assert the elements of knowledge of falsity, intent to induce reliance, and justifiable reliance. A cause of action for actual fraud was therefore not stated.

Constructive fraud arises on a breach of duty by one in a confidential or fiduciary relationship to another which induces justifiable reliance by the latter to his prejudice. Plaintiff, however, sets forth no facts to support his conclusion of a confidential relationship between the representatives of the school district and himself, other than that the parties bore the relationship of employer and employee to each other. Under prevailing judicial opinion no presumption of a confidential relationship arises from the bare fact that parties to a contract are employer and employee. We think the allegations of constructive fraud were inadequate.

⁵ [“A party to a contract may rescind the contract in the following cases . . . If the consent of the party rescinding, . . . was given by mistake, or obtained through duress, menace, fraud, or undue influence, exercised by or with the connivance of the party as to whom he rescinds, or of any other party to the contract jointly interested with such party.” CALIF. CIV. CODE § 1689(b)(1).—Eds.]

⁶ [An apparent consent is not real or free when obtained through:

1. Duress;
2. Menace;
3. Fraud;
4. Undue influence; or
5. Mistake.

Id. § 1567.—Eds.]

As to mistake, the amended complaint fails to disclose any facts which would suggest that consent had been obtained through a mistake of fact or of law. The material facts of the transaction were known to both parties. Neither party was laboring under any misapprehension of law of which the other took advantage.

However, the pleading does set out a claim that plaintiff's consent to the transaction had been obtained through the use of undue influence.

Undue influence, in the sense we are concerned with here, is a shorthand legal phrase used to describe persuasion which tends to be coercive in nature, persuasion which overcomes the will without convincing the judgment. The hallmark of such persuasion is high pressure, a pressure which works on mental, moral, or emotional weakness to such an extent that it approaches the boundaries of coercion. In this sense, undue influence has been called overpersuasion. Misrepresentations of law or fact are not essential to the charge, for a person's will may be overborne without misrepresentation. Undue influence includes "taking an unfair advantage of another's weakness of mind, or . . . taking a grossly oppressive and unfair advantage of another's necessities or distress." While most reported cases of undue influence involve persons who bear a confidential relationship to one another, a confidential or authoritative relationship between the parties need not be present when the undue influence involves unfair advantage taken of another's weakness or distress.

In essence undue influence involves the use of excessive pressure to persuade one vulnerable to such pressure, pressure applied by a dominant subject to a servient object. In combination, the elements of undue susceptibility in the servient person and excessive pressure by the dominating person make the latter's influence undue, for it results in the apparent will of the servient person being in fact the will of the dominant person.

In the present case plaintiff has pleaded that such weakness at the time he signed his resignation prevented him from freely and competently applying his judgment to the problem before him. Plaintiff declares he was under severe mental and emotional strain at the time because he had just completed the process of arrest, questioning, booking, and release on bail and had been without sleep for forty hours. It is possible that exhaustion and emotional turmoil may wholly incapacitate a person from exercising his judgment. As an abstract question of pleading, plaintiff has pleaded that possibility and sufficient allegations to state a case for rescission.

Undue influence in its second aspect involves an application of excessive strength by a dominant subject against a servient object. Judicial consideration of this second element in undue influence has been relatively rare, for there are few cases denying persons who persuade but do not misrepresent the benefit of their bargain. Yet logically, the same legal consequences should apply to the results of excessive strength as to the results of undue weakness. Whether from weakness on one side, or strength on the other, or a combination of the two, undue influence occurs

whenever there results “that kind of influence or supremacy of one mind over another by which that other is prevented from acting according to his own wish or judgment, and whereby the will of the person is overborne and he is induced to do or forbear to do an act which he would not do, or would do, if left to act freely.” Whether a person of subnormal capacities has been subjected to ordinary force or a person of normal capacities subjected to extraordinary force, the match is equally out of balance. If will has been overcome against judgment, consent may be rescinded.

Overpersuasion is generally accompanied by certain characteristics which tend to create a pattern. The pattern usually involves several of the following elements: (1) discussion of the transaction at an unusual or inappropriate time, (2) consummation of the transaction in an unusual place, (3) insistent demand that the business be finished at once, (4) extreme emphasis on untoward consequences of delay, (5) the use of multiple persuaders by the dominant side against a single servient party, (6) absence of third-party advisers to the servient party, (7) statements that there is no time to consult financial advisers or attorneys. If a number of these elements are simultaneously present, the persuasion may be characterized as excessive. The cases are illustrative:

In *Moore v. Moore*, 22 P. 589, 874 (Cal. 1890), the pregnant wife of a man who had been shot to death on October 30 and buried on November 1 was approached by four members of her husband’s family on November 2 or 3 and persuaded to deed her entire interest in her husband’s estate to his children by a prior marriage. In finding the use of undue influence on Mrs. Moore, the court commented:

It was the second day after her late husband’s funeral. It was at a time when she would naturally feel averse to transacting any business, and she might reasonably presume that her late husband’s brothers would not apply to her at such a time to transact any important business, unless it was of a nature that would admit of no delay. And as it would admit of delay, the only reason which we can discover for their unseemly haste is, that they thought that she would be more likely to comply with their wishes than at some future time, after she had recovered from the shock which she had then so recently experienced. If for that reason they selected that time for the accomplishment of their purpose, it seems to us that they not only took, but that they designed to take, an unfair advantage of her weakness of mind. If they did not, they probably can explain why they selected that inappropriate time for the transaction of business which might have been delayed for weeks without injury to anyone. In the absence of any explanation, it appears to us that the time was selected with reference to just that condition of mind which she alleges that she was then in. Taking an unfair advantage of another’s weakness of mind is undue influence, and the law will not permit the retention of an advantage thus obtained.

In *Weger v. Rocha*, 32 P.2d 417 (Cal. Ct. App. 1934), plaintiff, while confined in a cast in a hospital, gave a release of claims for personal injuries for a relatively small sum to an agent who spent two hours persuading her to sign. At the time of signing plaintiff was in a highly nervous and hysterical condition and suffering much pain, and she signed the release in order to terminate the interview. The court held that the release had been secured by the use of undue influence.

The difference between legitimate persuasion and excessive pressure, like the difference between seduction and rape,⁷ rests to a considerable extent in the manner in which the parties go about their business. For example, if a day or two after Odorizzi's release on bail the superintendent of the school district had called him into his office during business hours and directed his attention to those provisions of the Education Code compelling his leave of absence and authorizing his suspension on the filing of written charges, had told him that the district contemplated filing written charges against him, had pointed out the alternative of resignation available to him, had informed him he was free to consult counsel or any adviser he wished and to consider the matter overnight and return with his decision the next day, it is extremely unlikely that any complaint about the use of excessive pressure could ever have been made against the school district.

But, according to the allegations of the complaint, this is not the way it happened, and if it had happened that way, plaintiff would never have resigned.

Plaintiff has thus pleaded both subjective and objective elements entering the undue influence equation and stated sufficient facts to put in issue the question whether his free will had been overborne by defendant's agents at a time when he was unable to function in a normal manner.

We express no opinion on the merits of plaintiff's case, or the propriety of his continuing to teach school. We do hold that his pleading, liberally construed, states a cause of action for rescission of a transaction to which his apparent consent had been obtained through the use of undue influence.

The judgment is reversed.

Review Question 6. The *Odorizzi* case allows for the possibility on remand that the school district officials exercised undue influence in procuring Odorizzi's resignation. Were they acting in bad faith in putting pressure on Odorizzi? Do bad-

⁷ [An offensive example, but then again, this case is a reminder that courts and other officials were much less sensitive to many issues forty years ago.—Eds.]

faith motivations matter for purposes of undue influence analysis? *Should* the motives of the alleged influencer matter?

Review Question 7. *Odorizzi* strikes many students today as a case that should be more about civil rights than about contract defenses. To what extent should the role of a lawyer be to change the law (which Mr. Odorizzi's lawyers did not do) rather than to obtain a good result for an individual client (which Mr. Odorizzi's lawyers did do)? Do you value one role more than the other? If so, why?

WOOD v. BOYNTON

Supreme Court of Wisconsin
64 Wis. 265, 25 N.W. 42 (1885)

TAYLOR, J.

The defendants are partners in the jewelry business. On the trial it appeared that on and before the 28th of December, 1883, the plaintiff was the owner of and in the possession of a small stone of the nature and value of which she was ignorant; that on that day she sold it to one of the defendants for the sum of one dollar. Afterwards it was ascertained that the stone was a rough diamond, and of the value of about \$700. After learning this fact the plaintiff tendered the defendants the one dollar, and ten cents as interest, and demanded a return of the stone to her. The defendants refused to deliver it, and therefore she commenced this action.

The plaintiff testified to the circumstances attending the sale of the stone to Mr. Samuel B. Boynton, as follows:

The first time Boynton saw that stone he was talking about buying the topaz, or whatever it is, in September or October. I went into his store to get a little pin mended, and I had it in a small box—the pin, a small ear-ring; . . . this stone, and a broken sleeve-button were in the box. Mr. Boynton turned to give me a check for my pin. I thought I would ask him what the stone was, and I took it out of the box and asked him to please tell me what that was. He took it in his hand and seemed some time looking at it. I told him I had been told it was a topaz, and he said it might be. He says, “I would buy this; would you sell it?” I told him I did not know but what I would. What would it be worth? And he said he did not know; he would give me a dollar and keep it as a specimen, and I told him I would not sell it; and it was certainly pretty to look at. He asked me where I found it, and I told him in Eagle. He asked about how far out, and I said right in the village, and I went out. Afterwards, and about the 28th of December, I needed money pretty badly, and thought

every dollar would help, and I took it back to Mr. Boynton and told him I had brought back the topaz, and he says, “Well, yes; what did I offer you for it?” and I says, “One dollar;” and he stepped to the change drawer and gave me the dollar, and I went out.

In another part of her testimony she says:

Before I sold the stone I had no knowledge whatever that it was a diamond. I told him that I had been advised that it was probably a topaz, and he said probably it was. The stone was about the size of a canary bird’s egg, nearly the shape of an egg—worn pointed at one end; it was nearly straw color—a little darker.

She also testified that before this action was commenced she tendered the defendants \$1.10, and demanded the return of the stone, which they refused. This is substantially all the evidence of what took place at and before the sale to the defendants, as testified to by the plaintiff herself. She produced no other witness on that point.

In this case, upon the plaintiff’s own evidence, there can be no just ground for alleging that she was induced to make the sale she did by any fraud or unfair dealings on the part of Mr. Boynton. Both were entirely ignorant at the time of the character of the stone and of its intrinsic value. Mr. Boynton was not an expert in uncut diamonds, and had made no examination of the stone, except to take it in his hand and look at it before he made the offer of one dollar, which was refused at the time, and afterwards accepted without any comment or further examination made by Mr. Boynton. The appellant had the stone in her possession for a long time, and it appears from her own statement that she had made some inquiry as to its nature and qualities. If she chose to sell it without further investigation as to its intrinsic value to a person who was guilty of no fraud or unfairness which induced her to sell it for a small sum, she cannot repudiate the sale because it is afterwards ascertained that she made a bad bargain.

When this sale was made the value of the thing sold was open to the investigation of both parties, neither knew its intrinsic value, and, so far as the evidence in this case shows, both supposed that the price paid was adequate. How can fraud be predicated upon such a sale, even though after-investigation showed that the intrinsic value of the thing sold was hundreds of times greater than the price paid? It certainly shows no such fraud as would authorize the vendor to rescind the contract and bring an action at law to recover the possession of the thing sold.

We can find nothing in the evidence from which it could be justly inferred that Mr. Boynton, at the time he offered the plaintiff one dollar for the stone, had any knowledge of the real value of the stone, or that he entertained even a belief that the stone was a diamond. It cannot, therefore, be said that there was a suppression of

knowledge on the part of the defendant as to the value of the stone which a court of equity might seize upon to avoid the sale.

However unfortunate the plaintiff may have been in selling this valuable stone for a mere nominal sum, she has failed entirely to make out a case either of fraud or mistake in the sale such as will entitle her to a rescission of such sale so as to recover the property sold in an action at law.

Review Question 8. The rule here seems pretty straightforward, does it not? Absent fraud, the court ultimately leaves the risk of the unknown and uncertain to fall upon the contracting parties. Can you, however, square the reasoning and result in *Wood* with the outcome of next case, which was decided only two years later in a neighboring state?

SHERWOOD v. WALKER
Supreme Court of Michigan
66 Mich. 568, 33 N.W. 919 (1887)

MORSE, J.

Replevin for a cow. Suit commenced in justice's court. Judgment for plaintiff. Appealed to circuit court of Wayne County, and verdict and judgment for plaintiff in that court. The defendants bring error, and set out 25 assignments of the same.

The defendants reside at Detroit, but are in business at Walkerville, Ontario, and have a farm at Greenfield, in Wayne County, upon which were some blooded cattle supposed to be barren as breeders.⁸ The Walkers are importers and breeders of polled Angus cattle.

The plaintiff is a banker living at Plymouth, in Wayne County. He called upon the defendants at Walkerville for the purchase of some of their stock, but found none there that suited him. Meeting one of the defendants afterwards, he was informed that they had a few head upon this Greenfield farm. He was asked to go out and look

⁸ [The defendants were Hiram Walker & Sons, the distillery that produced (and still produces) Canadian Club whiskey and other alcoholic beverages. Importing polled Angus cattle from Scotland was a side business; Walker used the left-over mash from whiskey production as cattle feed. He also himself raised the grain used in the distilling process. Hiram Walker himself founded the "model town" of Walkerville, Ontario, a planned community where his workers lived.—Eds.]

at them, with the statement at the time that they were probably barren, and would not breed.

May 5, 1886, plaintiff went out to Greenfield and saw the cattle. A few days thereafter, he called upon one of the defendants with the view of purchasing a cow, known as "Rose 2d of Aberlone." After considerable talk, it was agreed that defendants would telephone Sherwood at his home in Plymouth in reference to the price. The second morning after this talk he was called up by telephone, and the terms of the sale were finally agreed upon. [Sherwood] requested defendants to confirm the sale in writing, which they did by sending him the following letter:

Walkerville, May 15, 1886.

T.
President, etc.:—

C.

Sherwood,

Dear Sir: We confirm sale to you of the cow Rose 2d of Aberlone, lot 56 of our catalogue, at five and a half cents per pound, less fifty pounds shrink. We inclose herewith order on Mr. Graham for the cow. You might leave check with him, or mail to us here, as you prefer.

Yours truly,

Hiram Walker & Sons.

On the twenty-first of the same month the plaintiff went to defendants' farm at Greenfield, and presented the order and letter to Graham, who informed him that the defendants had instructed him not to deliver the cow. Soon after, the plaintiff tendered to Hiram Walker, one of the defendants, \$80, and demanded the cow. Walker refused to take the money or deliver the cow. The plaintiff then instituted this suit.

The defendants then introduced evidence tending to show that at the time of the alleged sale it was believed by both the plaintiff and themselves that the cow was barren and would not breed; that she cost \$850, and if not barren would be worth from \$750 to \$1,000; that after the date of the letter, and the order to Graham, the defendants were informed by said Graham that in his judgment the cow was with calf, and therefore they instructed him not to deliver her to plaintiff, and on the twentieth of May, 1886, telegraphed to the plaintiff what Graham thought about the cow being with calf, and that consequently they could not sell her. The cow had a calf in the month of October following.

It appears from the record that both parties supposed this cow was barren and would not breed, and she was sold by the pound for an insignificant sum as compared with her real value if a breeder. She was evidently sold and purchased on the relation of her value for beef, unless the plaintiff had learned of her true condition, and concealed such knowledge from the defendants. Before the plaintiff secured possession of the animal, the defendants learned that she was with calf, and therefore

of great value, and undertook to rescind the sale by refusing to deliver her. The question arises whether they had a right to do so.

The circuit judge ruled that this fact did not avoid the sale, and it made no difference whether she was barren or not. I am of the opinion that the court erred in this holding. I know that this is a close question, and the dividing line between the adjudicated cases is not easily discerned. But it must be considered as well settled that a party who has given an apparent consent to a contract of sale may refuse to execute it, or he may avoid it after it has been completed, if the assent was founded, or the contract made, upon the mistake of a material fact such as the subject-matter of the sale, the price, or some collateral fact materially inducing the agreement; and this can be done when the mistake is mutual. 1 JUDAH P. BENJAMIN, *TREATISE ON THE LAW OF SALE OF PERSONAL PROPERTY* §§ 605, 606 (1868);⁹ STEPHEN MARTIN LEAKE, *ELEMENTS OF THE LAW OF CONTRACTS* 339 (1867). *See also Allen v. Hammond*, 36 U.S. 63 (1837).

If there is a difference or misapprehension as to the substance of the thing bargained for, if the thing actually delivered or received is different in substance from the thing bargained for and intended to be sold, then there is no contract; but if it be only a difference in some quality or accident, even though the mistake may have been the actuating motive to the purchaser or seller, or both of them, yet the contract remains binding.

“The difficulty in every case is to determine whether the mistake or misapprehension is as to the substance of the whole contract, going, as it were, to the root of the matter, or only to some point, even though a material point, an error as to which does not affect the substance of the whole consideration.” *Kennedy v. Panama, etc., Mail Co.*, L.R. 2 Q.B. 580, 588.

It has been held, in accordance with the principles above stated, that where a horse is bought under the belief that he is sound, and both vendor and vendee honestly believe him to be sound, the purchaser must stand by his bargain, and pay the full price, unless there was a warranty.

It seems to me, however, in the case made by this record, that the mistake or misapprehension of the parties went to the whole substance of the agreement. If the cow was a breeder, she was worth at least \$750; if barren, she was worth not over \$80. The parties would not have made the contract of sale except upon the understanding and belief that she was incapable of breeding, and of no use as a cow. It is true she is now the identical animal that they thought her to be when the contract

⁹ [Civil War buffs may be interested that this is the same Judah P. Benjamin who served successively as attorney general, secretary of war, and secretary of state in the Confederate States of America. After the end of the war he moved to England, qualified as a barrister, and became one of the most prominent commercial lawyers in Great Britain. His treatise *Benjamin on Sales*, now in its 9th edition, is still in print.—Eds.]

was made; there is no mistake as to the identity of the creature. Yet the mistake was not of the mere quality of the animal, but went to the very nature of the thing. A barren cow is substantially a different creature than a breeding one. There is as much difference between them for all purposes of use as there is between an ox and a cow that is capable of breeding and giving milk. She was not a barren cow, and, if this fact had been known, there would have been no contract. The mistake affected the substance of the whole consideration, and it must be considered that there was no contract to sell or sale of the cow as she actually was. The thing sold and bought had in fact no existence. She was sold as a beef creature would be sold; she is in fact a breeding cow, and a valuable one.

The judgment of the court below must be reversed, and a new trial granted, with costs of this Court to defendants.

Review Question 9. A pebble thought to be just a pretty stone turns out to be a diamond in *Wood*, and the seller loses. A cow thought to be barren turns out to be fertile in *Sherwood*, and the seller wins. In *Sherwood*, the court says that a horse that's lame is not different from a horse that is healthy, but a cow that is barren is different from a cow that is fertile. Can you reconcile the reasoning of *Wood* and *Sherwood*?

Review Question 10. In the preceding two cases, the mistake was a *mutual mistake*—that is, both parties were said to share the same misconception. What happens when only *one* of the parties to the agreement is mistaken? Review Restatement (Second) of Contracts § 153. Under what circumstances can a party get out of a contract based on that party's own *unilateral mistake*?

Problems

Problem 15.1

Moe is the owner of a piece of real estate, which he has listed at \$220,000. Larry offers to buy the real estate for \$200,000. Larry wants the property because he knows that a new shopping mall project is coming in and that the developer will pay \$400,000 for the property. Moe does not know of the development, and Larry is aware of his ignorance. After some negotiation, the two settle on a price of \$210,000. Just before the deal is signed, Moe asks, "Do you know anything about this property that

you think I'd want to know about before we sign?" Larry says, "No." When Moe learns of the development he sues to rescind the sale. What result?

Problem 15.2

The town of Amity Beach is a bustling summer seaside resort near Martha's Vineyard. Its economy is based wholly on three months of summer tourism.

Recently a great white shark of unusual size and tenacity has been eating bathers along the shore, creating a great deal of bad publicity and driving tourists away. At a town meeting, everyone is distressed over the potential loss of revenue for the summer. The town council tries to calm the citizens down, but it is difficult. No one has any good suggestions for what to do. Eventually, a local fisherman, Quint, stands up. He makes the following statement:

Y'all know me. Know how *I* earn a livin'. I'll catch this bird for you, but it ain't gonna be easy. Bad fish. Not like going down the pond chasin' bluegills and tommycods. This shark, swallow you whole. Little shakin', little tenderizin', an' down you go. And we gotta do it quick, that'll bring back your tourists, put all your businesses on a payin' basis. But it's not gonna be pleasant. I value my neck a lot more than three thousand bucks, chief. I'll find him for three, but I'll catch him, and kill him, for one hundred. But you've gotta make up your minds. If you want to stay alive, then ante up. If you want to play it cheap, be on welfare the whole winter. I don't want no volunteers, I don't want no mates, there's just too many captains on this island. One hundred thousand dollars for me by myself. For that you get the head, the tail, the whole damn thing.

Quint adds that this is the deal, take it or leave it, and if he leaves the room without an agreement the town can starve to death as far as he's concerned. As there are no other options on the table, the council reluctantly agrees to hire Quint.

Quint eventually catches the shark and brings it back. The town's summer is saved. The council refuses, however, to pay him the \$100,000. The reasonable fee for his boat and services would be \$1,500, but the City offers \$10,000. Quint sues. What result and why?

Problem 15.3

Buyer is a regular attendee at garage sales in her town. While at a sale at the home of Seller, Buyer sees a rather dull and dirty landscape painting in a rather gaudy modern frame. Buyer, who thinks that the colors in the painting would go well in her living room (once the thing is cleaned up) offers \$50, and after some negotiation she and Seller agree to a sale at \$85. The painting is subsequently proved to be a lost painting by American luminist artist Sanford Robinson Gifford (1823-1880). The

Sotheby's auction house appraises the painting at \$100,000 to \$130,000. At no time prior to the sale was Buyer aware that the painting was a Gifford. Immediately upon learning of the identification, Seller sues to rescind the contract on grounds of mutual mistake. What result and why?

Problem 15.4

Tyson Foods, Inc., signs a contract to deliver 50,000 frozen chickens to Nördliche Geflügelzucht GmbH, a German poultry processor. The contract specifies:

US Fresh Frozen Chicken, Grade A, Government Inspected, Eviscerated 2 1/2-3 lbs. each all chicken individually wrapped in cryovac, packed in secured fiber cartons or wooden boxes, suitable for export, 200,000 lbs. 2 1/2-3 lbs @\$ 82.15 per 100 lbs. FAS New York

Tyson ships the chicken. When it receives the shipment, Nördliche objects, claiming that it was expecting "broiling or frying chickens" (which are young and tender) but instead received "stewing chickens" (which are old and tough). Tyson says that it understood that any fresh frozen chicken that met the weight requirements would be suitable under the contract. Assume that both parties are telling the truth and that neither knew of the meaning attached by the other. Nördliche rejects the chicken and refuses to pay. Tyson sues. Nördliche raises several defenses, among them mutual mistake.

Will the mutual mistake defense work? Why or why not?

Unit 16: Policy-Based Defenses

CONTRACT DEFENSES Part Four

FOCUS OF THIS UNIT

Enforceability is what makes a contract different from a mere agreement. Enforceability means that the parties can enlist the coercive power of the government to make the breaching party do what it promised to do (in some cases), or pay damages for failing to do so (in far more cases). As a consequence, the “private” agreement between the parties has a “public” aspect to it. While the private ordering agreed to by the parties predominates, the public at large actually has some interest in those things to which the private parties can and cannot agree. For these reasons several defenses to otherwise enforceable contracts are what we call “policy-based.” There is some enforcement that the government simply will not do.

Enforcement is Good, Except When It Isn’t. The common-law system of contracts rests on a general premise that enforcing private agreements is a good thing and is therefore an important public policy of the state. Governments have many other policies, however, and sometimes those policies conflict with the policy that parties should be free to contract as they see fit.

Illegal Contracts. Very early on, for example, courts would not uphold contracts that were themselves illegal (such as contracts to fix prices in violation of antitrust law), or that called for the commission of crimes or torts (such as murder or property damage), or that violated public morals (such as gambling or prostitution). The basic rule with respect to such contracts is that they are void (not merely voidable). This means that if A has paid B \$10,000 to kill C, and B fails to do so, A cannot bring a contract claim to recover the payment. If a customer fails to pay a prostitute or a drug dealer for goods or services, or a prostitute or drug dealer fails to deliver what was promised, no contract remedy generally exists. We will see later that in some cases courts may order *restitution* of benefits conferred in some more technical categories of illegality (which would not include murder, prostitution, or illegal drugs).

Against Public Policy. In many situations, a particular contract is not specifically *illegal*, but enforcing the deal would require the court—an agency of the government—to act contrary to other important government interests.

For purposes of analyzing these “public policy” types of cases, it is useful to start with a simple framework. First, is there a significant public policy involved? Such policies may be found in statutes or in the common law, but the initial step is to figure out exactly what the policy is. Second, would enforcement of the contract conflict with that policy? What exactly is the interference that is threatened? Third, do the public policy concerns outweigh the public interest in enforcing contracts generally? These situations can vary a great deal from one jurisdiction to the next, making it difficult to make any categorical statements about American law here. Consider, for instance, the *In re Baby M* surrogacy contract from the beginning of the course. What New Jersey found unenforceable might find a welcome home in another state. Review Chapter 8 (“Unenforceability on Grounds of Public Policy”) of the Restatement (Second) of Contracts (§§ 178 – 199) to get a general feel for the current state of public-policy analysis in contract law.

As you might gather, public policy is often in the mind of the beholder. Courts (and legislatures, too) can and do strongly disagree amongst themselves over the existence of particular policies, over whether particular contracts conflict with those policies, and over how conflicting policies should be weighed against one another. Three of the most common and important categories of contracts that involve public policies are (1) contracts that restrict competition, (2) contracts that limit tort liability, and (3) contracts that impair family law obligations. We already saw the third category in the *Baby M* case, so the readings below will address the first two.

Unconscionability: Policing Fairness. Beyond the long-established concept of contracts against public policy is the much more recent doctrine of *unconscionability*. Historically, the common law did not let people out of bad bargains unless they fell under one of the assent-based defenses—fraud, misrepresentation, duress, undue influence, or mistake. In some contracts, no one has lied, no threat has been made, no party’s free will has been taken away, and no party has made a fundamental mistake. Despite the absence of traditional defenses, the deal itself seems so unfair that courts will refuse to enforce it. These were sometimes said to be contracts that “no honest man would offer and no sane man would sign.” Despite its noble intentions, unconscionability doctrine has proven to be a particular challenge in its actual application.

Cases and Materials

WILLIAM L. CLARK, JR., HANDBOOK OF THE LAW OF CONTRACTS

(2d ed. Francis B. Tiffany 1904)

154. Any agreement which is contrary to the policy of the law, or public policy, because of its mischievous nature or tendency, is illegal and void, though the acts contemplated may not be expressly prohibited either by the common law or by statute.

155. The test of public policy must be applied in each case as it arises, and therefore agreements which have been or may be declared contrary to public policy cannot be exactly classified. The most general are:

- (a) Agreements tending to injure the public service.
- (b) Agreements involving or tending to the corruption of private citizens with respect to public matters.
- (c) Agreements tending to pervert or obstruct public justice.
- (d) Agreements tending to encourage litigation.
- (e) Agreements of immoral tendency.
- (f) Gambling transactions.
- (g) Agreements tending to induce fraud and breach of trust.
- (h) Agreements affecting the freedom or security of marriage, or otherwise in derogation of the marriage relationship.
- (i) Agreements in derogation of the parental relation.
- (j) Agreements in unreasonable restraint of trade, including combinations to prevent competition, control prices, and prevent monopolies.
- (k) Agreements exempting a person or corporation from liability for negligence.

Review Question 1. As the 1904 Clark treatise demonstrates, the roots of the public policy defense go back fairly far and have covered a broad range of topics. Do you think any of the listed categories of suspect contracts would not be categorized as against public policy today? Which ones? Can you think of any categories of contract *not* in Clark's list where a court today might consider their enforcement to be against public policy?

HANKS v. POWDER RIDGE RESTAURANT CORP.

Supreme Court of Connecticut

SULLIVAN, C. J.

The defendants operate a facility in Middlefield, known as Powder Ridge, at which the public, in exchange for a fee, is invited to ski, snowboard and snowtube. On February 16, 2003, the plaintiff brought his three children and another child to Powder Ridge to snowtube. Neither the plaintiff nor the four children had ever snowtubed at Powder Ridge, but the snowtubing run was open to the public generally, regardless of prior snowtubing experience, with the restriction that only persons at least six years old or forty-four inches tall were eligible to participate. Further, in order to snowtube at Powder Ridge, patrons were required to sign a “Waiver, Defense, Indemnity and Hold Harmless Agreement, and Release of Liability.” The plaintiff read and signed the agreement on behalf of himself and the four children. While snowtubing, the plaintiff’s right foot became caught between his snow tube and the man-made bank of the snowtubing run, resulting in serious injuries that required multiple surgeries to repair.

Thereafter, the plaintiff filed the present negligence action against the defendants.

The defendants moved for summary judgment, claiming that the agreement barred the plaintiff’s negligence claim as a matter of law. The trial court, relying on *Hyson v. White Water Mountain Resorts of Connecticut, Inc.*, 829 A.2d 827 (Conn. 2003), agreed and rendered summary judgment in favor of the defendants. This appeal followed.

We first address the plaintiff’s claim that the agreement does not expressly release the defendants from liability for personal injuries incurred as a result of their own negligence as required by *Hyson*. Specifically, the plaintiff maintains that an ordinary person of reasonable intelligence would not understand that, by signing the agreement, he or she was releasing the defendants from liability for future negligence. We disagree.

The agreement at issue in the present case provides in relevant part:

I understand that there are inherent risks involved in snowtubing, including the risk of serious physical injury or death and *I fully assume all risks associated with snowtubing*, even if due to the NEGLIGENCE of [the defendants] including but not limited to: variations in the snow conditions; steepness and terrain; the presence of ice, moguls, bare spots and objects beneath the snowtubing surface such as rocks, debris and tree stumps; collisions with objects both on and off the snowtubing chutes such as hay bales, trees, rocks, snowmaking equipment, barriers, lift cables and equipment, lift towers, lift attendants, employees, volunteers, other patrons and spectators or their property; equipment or lift condition or failure; lack of safety devices or inadequate safety devices; lack of

warnings or inadequate warnings; lack of instructions or inadequate instructions; use of any lift; and the like. . . . I hereby release, and agree that *I will not sue* [the defendants] for money damages for personal injury or property damage sustained by me while using the snowtubing facilities and equipment even if due to the NEGLIGENCE of [the defendants].

(Emphasis in original.)

We conclude that the agreement expressly and unambiguously purports to release the defendants from prospective liability for negligence. An ordinary person of reason able intelligence would understand that, by signing the agreement, he or she was releasing the defendants from liability for their future negligence.

We next address the issue we explicitly left unresolved in *Hyson*, namely, whether the enforcement of a well drafted exculpatory agreement purporting to release a snowtube operator from prospective liability for personal injuries sustained as a result of the operator's negligent conduct violates public policy.

Although it is well established that parties are free to contract for whatever terms on which they may agree, it is equally well established that contracts that violate public policy are unenforceable. The question of whether a contract is against public policy is a question of law dependent on the circumstances of the particular case, over which an appellate court has unlimited review.

The law does not favor contract provisions which relieve a person from his own negligence. This is because exculpatory provisions undermine the policy considerations governing our tort system. The fundamental policy purposes of the tort compensation system are compensation of innocent parties, shifting the loss to responsible parties or distributing it among appropriate entities, and deterrence of wrongful conduct. It is sometimes said that compensation for losses is the primary function of tort law but it is perhaps more accurate to describe the primary function as one of determining when compensation is required. An equally compelling function of the tort system is the prophylactic factor of preventing future harm. The courts are concerned not only with compensation of the victim, but with admonition of the wrongdoer. Thus, it is consistent with public policy to posit the risk of negligence upon the actor and, if this policy is to be abandoned, it has generally been to allow or require that the risk shift to another party better or equally able to bear it, not to shift the risk to the weak bargainer.

Although this court previously has not addressed the enforceability of a release of liability for future negligence, the issue has been addressed by many of our sister states. A frequently cited standard for determining whether exculpatory agreements violate public policy was set forth by the Supreme Court of California in *Tunkl v. Regents of the University of California*, 383 P.2d 441 (Cal. 1963). In *Tunkl*, the court concluded that exculpatory agreements violate public policy if they affect the public interest adversely, and identified six factors (*Tunkl* factors) relevant to this determination: [1] The agreement concerns a business of a type generally thought

suitable for public regulation. [2] The party seeking exculpation is engaged in performing a service of great importance to the public, which is often a matter of practical necessity for some members of the public. [3] The party holds himself out as willing to perform this service for any member of the public who seeks it, or at least for any member coming within certain established standards. [4] As a result of the essential nature of the service, in the economic setting of the transaction, the party invoking exculpation possesses a decisive advantage of bargaining strength against any member of the public who seeks his services. [5] In exercising a superior bargaining power the party confronts the public with a standardized adhesion contract of exculpation, and makes no provision whereby a purchaser may pay additional reasonable fees and obtain protection against negligence. [6] Finally, as a result of the transaction, the person or property of the purchaser is placed under the control of the seller, subject to the risk of carelessness by the seller or his agents. The court clarified that an exculpatory agreement may affect the public interest adversely even if some of the *Tunkl* factors are not satisfied.

Various states have adopted the *Tunkl* factors to determine whether exculpatory agreements affect the public interest adversely and, thus, violate public policy. See, e.g., *Anchorage v. Locker*, 723 P.2d 1261, 1265 (Alaska 1986); *Olson v. Molzen*, 558 S.W.2d 429, 431 (Tenn. 1977); *Wagenblast v. Odessa School District*, 758 P.2d 968 (Wash. 1988). Other states have developed their own variations of the *Tunkl* factors; see, e.g., *Jones v. Dressel*, 623 P.2d 370, 376 (Colo. 1981) *Rawlings v. Layne & Bowler Pump Co.*, 465 P.2d 107 (Idaho 1970), while still others have adopted a totality of the circumstances approach. See, e.g., *Wolf v. Ford*, 644 A.2d 522 (Md. 1994); *Dalury v. S-K-I, Ltd.*, A.2d 795 (Vt. 1995). The Virginia Supreme Court, however, has determined that all exculpatory agreements purporting to release tortfeasors from future liability for personal injuries are unenforceable because “to hold that it was competent for one party to put the other parties to the contract at the mercy of its own misconduct can never be law fully done where an enlightened system of jurisprudence prevails. Public policy forbids it.” *Hiatt v. Lake Barcroft Community Ass’n*, 418 S.E.2d 894 (Va. 1992).

Having reviewed the various methods for determining whether exculpatory agreements violate public policy, we conclude, as the *Tunkl* court itself acknowledged, that “no definition of the concept of public interest can be contained within the four corners of a formula.” Accordingly, we agree with the Supreme Courts of Maryland and Vermont that “the ultimate determination of what constitutes the public interest must be made considering the totality of the circumstances of any given case against the backdrop of current societal expectations.” Thus, our analysis is guided, but not limited, by the *Tunkl* factors, and is informed by any other factors that may be relevant given the factual circumstances of the case and current societal expectations.

We now turn to the merits of the plaintiff's claim. The defendants are in the business of providing snowtubing services to the public generally, regardless of prior snowtubing experience, with the minimal restriction that only persons at least six years old or forty-four inches tall are eligible to participate. Given the virtually unrestricted access of the public to Powder Ridge, a reasonable person would presume that the defendants were offering a recreational activity that the whole family could enjoy safely. Indeed, this presumption is borne out by the plaintiff's own testimony. Specifically, the plaintiff testified that he "trusted that [the defendants] would, within their good conscience, operate a safe ride."

The societal expectation that family oriented recreational activities will be reasonably safe is even more important where, as in the present matter, patrons are under the care and control of the recreational operator as a result of an economic transaction. The plaintiff, in exchange for a fee, was permitted access to the defendants' snowtubing runs and was provided with snowtubing gear. As a result of this transaction, the plaintiff was under the care and control of the defendants and, thus, was subject to the risk of the defendants' carelessness. Specifically, the defendants designed and maintained the snowtubing run and, therefore, controlled the steepness of the incline, the condition of the snow and the method of slowing down or stopping patrons. Further, the defendants provided the plaintiff with the requisite snowtubing supplies and, therefore, controlled the size and quality of the snow tube as well as the provision of any necessary protective gear. Accordingly, the plaintiff voluntarily relinquished control to the defendants with the reasonable expectation of an exciting, but reasonably safe, snowtubing experience.

Moreover, the plaintiff lacked the knowledge, experience and authority to discern whether, much less ensure that, the defendants' snowtubing runs were maintained in a reasonably safe condition. As the Vermont Supreme Court observed, in the context of the sport of skiing, it is consistent with public policy

to place responsibility for maintenance of the land on those who own or control it, with the ultimate goal of keeping accidents to the minimum level possible. [The] defendants, not recreational skiers, have the expertise and opportunity to foresee and control hazards, and to guard against the negligence of their agents and employees. They alone can properly maintain and inspect their premises, and train their employees in risk management. They alone can insure against risks and effectively spread the costs of insurance among their thousands of customers. Skiers, on the other hand, are not in a position to discover and correct risks of harm, and they cannot insure against the ski area's negligence.

If the defendants were permitted to obtain broad waivers of their liability, an important incentive for ski areas to manage risk would be removed, with the public bearing the cost of the resulting injuries. It is illogical, in these circumstances, to undermine the public policy

underlying business invitee law and allow skiers to bear risks they have no ability or right to control.¹

Dalury v. S-K-I, Ltd., supra.

Further, the agreement at issue was a standardized adhesion contract offered to the plaintiff on a “take it or leave it” basis. The most salient feature of adhesion contracts is that they are not subject to the normal bargaining processes of ordinary contracts. See BLACK’S LAW DICTIONARY (7TH ED. 1999) (defining adhesion contract as “[a] standard form contract prepared by one party, to be signed by the party in a weaker position, [usually] a consumer, who has little choice about the terms”). Not only was the plaintiff unable to negotiate the terms of the agreement, but the defendants also did not offer him the option of procuring protection against negligence at an additional reasonable cost. See Restatement (Third), Torts, *Apportionment of Liability* § 2, comment (e), p. 21 (2000) (factor relevant to enforcement of contractual limit on liability is “whether the party seeking exculpation was willing to provide greater protection against tortious conduct for a reasonable, additional fee”). Moreover, the defendants did not inform prospective snowtubers prior to their arrival at Powder Ridge that they would have to waive important common-law rights as a condition of participation. Thus, the plaintiff, who traveled to Powder Ridge in anticipation of snowtubing that day, was faced with the dilemma of either signing the defendants’ proffered waiver of prospective liability or forgoing completely the opportunity to snowtube at Powder Ridge. Under the present factual circumstances, it would ignore reality to conclude that the plaintiff wielded the same bargaining power as the defendants.

In the present case, the defendants held themselves out as a provider of a healthy, fun, family activity. After the plaintiff and his family arrived at Powder Ridge eager to participate in the activity, however, the defendants informed the plaintiff that, not only would they be immune from claims arising from the inherent risks of the activity, but they would not be responsible for injuries resulting from their own carelessness and negligence in the operation of the snowtubing facility. We recognize that the plaintiff had the option of walking away. We cannot say, however, that the defendants had no bargaining advantage under these circumstances.

¹ [By the court] Exculpatory agreements, like the one at issue in the present matter, shift the costs of injuries from the tortfeasor to the person injured. As a consequence, health care insurance providers or the state, through its provision of medicaid benefits, absorb the costs of the tortfeasor’s negligence. These costs necessarily are passed on to the population of the state through higher health care premiums and state taxes. Accordingly, in the present matter, it ultimately would be the population generally, and not the snowtube operators and their patrons, who would bear the costs if these agreements were to be enforced.

For the foregoing reasons, we conclude that the agreement in the present matter affects the public interest adversely and, therefore, is unenforceable because it violates public policy. Accordingly, the trial court improperly rendered summary judgment in favor of the defendants.

The defendants and the dissent point out that our conclusion represents the “distinct minority view” and is inconsistent with the majority of sister state authority upholding exculpatory agreements in similar recreational settings. We acknowledge that most states uphold adhesion contracts releasing recreational operators from prospective liability for personal injuries caused by their own negligent conduct. Put simply, we disagree with these decisions for the reasons already explained in this opinion.

The judgment is reversed and the case is remanded for further proceedings according to law.

NORCOTT, J., dissenting.

I would follow the overwhelming majority of our sister states and would conclude that prospective releases from liability for negligence are permissible in the context of recreational activities. Accordingly, I respectfully dissent from the majority’s decision to take a road that is, for many persuasive reasons, far less traveled.

[The dissent applies the *Tunkl* factors, noting that snowtubing, unlike skiing, is not generally regulated in Connecticut; that snowtubing, unlike medical services, child care, banking, and real estate services, is not an “important public service”; that snowboarding is a purely personal, recreational activity that causes no harm if not engaged in; and that the essence of snowtubing is that one races down a hill *without* being under the control of the provider.]

In sum, I conclude that, under the *Tunkl* factors, the defendants’ release at issue in this case does not violate public policy with respect to the sport of snowtubing. This conclusion is consistent with the vast majority of sister state authority, which upholds releases of liability in a variety of recreational or athletic settings that are akin to snowtubing as not violative of public policy. It also is consistent with the view of the American Law Institute, as embodied in Restatement (Second) of Contracts § 195 (1981).² I, therefore, respectfully dissent.

² [By the court] Restatement (Second) of Contracts § 195 (1981) provides in relevant part:

(2) A term exempting a party from tort liability for harm caused negligently is unenforceable on grounds of public policy if

(a) the term exempts an employer from liability to an employee for injury in the course of his employment;

Review Question 2. The dissent, a majority of states, and section 195 of the Restatement (Second) of Contracts take a position under which the release in *Hanks* would be enforced. What would the policies be that *favor* enforcement of a contract excusing negligence? If parties have the ability to contract around the duty not to be negligent, how much does that undermine a fundamental purpose of tort law?

VALLEY MEDICAL SPECIALISTS v. FARBER

Supreme Court of Arizona

194 Ariz. 363, 982 P.2d 1277 (en banc 1999)

FELDMAN, J.

In 1985, Valley Medical Specialists (“VMS”), a professional corporation, hired Steven S. Farber, D.O., an internist and pulmonologist who, among other things, treated AIDS and HIV-positive patients and performed brachytherapy—a procedure that radiates the inside of the lung in lung cancer patients. Brachytherapy can only be performed at certain hospitals that have the necessary equipment. A few years after joining VMS, Dr. Farber became a shareholder and subsequently a minority officer and director. In 1991, the three directors, including Dr. Farber, entered into new stock and employment agreements. The employment agreement contained a restrictive covenant, the scope of which was amended over time.

In 1994, Dr. Farber left VMS and began practicing within the area defined by the restrictive covenant, which at that time read as follows:

The parties recognize that the duties to be rendered under the terms of this Agreement by the Employee are special, unique and of an extraordinary character. The Employee, in consideration of the compensation to be paid to him pursuant to the terms of this Agreement, expressly agrees to the following restrictive covenants:

(a) The Employee shall not, directly or indirectly:

...

(b) the term exempts one charged with a duty of public service from liability to one to whom that duty is owed for compensation for breach of that duty, or

(c) the other party is similarly a member of a class protected against the class to which the first party belongs.

(ii) Either separately, jointly, or in association with others, establish, engage in, or become interested in, as an employee, owner, partner, shareholder or otherwise, or furnish any information to, work for, or assist in any manner, anyone competing with, or who may compete with the Employer in the practice of medicine.

...

(iv) Either separately, jointly or in association with others to provide medical care or medical assistance for any person or persons who were patients or [sic] Employer during the period that Employee was in the hire of Employer.

...

(d) The restrictive covenants set forth herein shall continue during the term of this Agreement and for a period of three (3) years after the date of termination, for any reason, of this Agreement. The restrictive covenants set forth herein shall be binding upon the Employee in that geographical area encompassed within the boundaries measured by a five (5) mile radius of any office maintained or utilized by Employer at the time of execution of the Agreement or at any time thereafter.

VMS filed a complaint against Dr. Farber seeking (1) preliminary and permanent injunctions enjoining Dr. Farber from violating the restrictive covenant, (2) liquidated damages for breach of the employment agreement, and (3) damages for breach of fiduciary duty, conversion of patient files and confidential information, and intentional interference with contractual and/or business relations.

Following six days of testimony and argument, the trial court denied VMS's request for a preliminary injunction, finding that the restrictive covenant violated public policy.

The court of appeals reversed, concluding that a modified covenant was reasonable.

A brief reference to basic principles is appropriate. Historically, covenants not to compete were viewed as restraints of trade and were invalid at common law. Eventually, ancillary restraints, such as those incident to employment or partnership agreements, were enforced under the rule of reason. *See* Restatement (Second) of Contracts § 188 (1981).

A covenant not to compete is invalid unless it protects some legitimate interest beyond the employer's desire to protect itself from competition. The legitimate purpose of post-employment restraints is to prevent competitive use, for a time, of information or relationships which pertain peculiarly to the employer and which the employee acquired in the course of the employment. Despite the freedom to contract, the law does not favor restrictive covenants.

We first address the level of scrutiny that should be afforded to this restrictive covenant. Dr. Farber argues that this contract is simply an employer-employee agreement and thus the restrictive covenant should be strictly construed against the employer. *See Amex Distributing Co. v. Mascari*, 724 P.2d 596, 600 (Ariz. Ct. App.

1986) (noting employer-employee restrictive covenants are disfavored and strictly construed against the employer). This was the approach taken by the trial court. VMS contends that this is more akin to the sale of a business; thus, the noncompete provision should not be strictly construed against it. *See id.* (courts more lenient in enforcing restrictive covenants connected to sale of business because of need to effectively transfer goodwill). Finding the agreement here not on all fours with either approach, the court of appeals applied a standard “somewhere between” the two.

Although this agreement is between partners, it is more analogous to an employer-employee agreement than a sale of a business. *See* Restatement § 188 cmt. h (“A rule similar to that applicable to an employee or agent applies to a partner who makes a promise not to compete that is ancillary to the partnership agreement or to an agreement by which he disposes of his partnership interest.”). Many of the concerns present in the sale of a business are not present or are reduced where, as here, a physician leaves a medical group, even when that physician is a partner. When a business is sold, the value of that business’s goodwill usually figures significantly into the purchase price. The buyer therefore deserves some protection from competition from the former owner. A restraint accompanying the sale of a business is necessary for the buyer to get the full goodwill value for which it has paid.

It is true that in this case, unlike typical employer-employee agreements, Dr. Farber may not have been at a bargaining disadvantage, which is one of the reasons such restrictive covenants are strictly construed. Unequal bargaining power may be a factor to consider when examining the hardship on the departing employee. But in cases involving the professions, public policy concerns may outweigh any protectable interest the remaining firm members may have. Thus, this case does not turn on the hardship to Dr. Farber.

By restricting a physician’s practice of medicine, this covenant involves strong public policy implications and must be closely scrutinized. Although stopping short of banning restrictive covenants between physicians, the American Medical Association (“AMA”) “discourages” such covenants, finding they are not in the public interest.

The Council on Ethical and Judicial Affairs discourages any agreement between physicians which restricts the right of a physician to practice medicine for a specified period of time or in a specified area upon termination of employment or a partnership or a corporate agreement. Such restrictive agreements are not in the public interest.

1989 CURRENT OPINIONS OF THE COUNCIL ON ETHICAL AND JUDICIAL Affairs § 9.02 (hereinafter “AMA Opinions”). In addition, the AMA recognizes that free choice of doctors is the right of every patient, and free competition among physicians is a prerequisite of optimal care and ethical practice. *See* AMA OPINIONS § 9.06.

For similar reasons, restrictive covenants are prohibited between attorneys. In 1969, the American Bar Association adopted a code of professional conduct that contained a disciplinary rule prohibiting restrictive covenants between attorneys. The ethical rules adopted by this court provide:

A lawyer shall not participate in offering or making:

(a) a partnership or employment agreement that restricts the rights of a lawyer to practice after termination of the relationship except an agreement concerning benefits upon retirement; or

(b) an agreement in which a restriction on the lawyers right to practice is part of the settlement of a controversy between private parties.

Ethical Rule (“ER”) 5.6, Arizona Rules of Professional Conduct, Rule 42.

Restrictive covenants between lawyers limit not only their professional autonomy but also the client’s freedom to choose a lawyer. We do not, of course, enact ethical rules for the medical profession, but given the view of the AMA to which we have previously alluded, we believe the principle behind prohibiting restrictive covenants in the legal profession is relevant.

Commercial standards may not be used to evaluate the reasonableness of lawyer restrictive covenants. Strong public policy considerations preclude their applicability. In that sense lawyer restrictions are injurious to the public interest. A client is always entitled to be represented by counsel of his own choosing. The attorney-client relationship is consensual, highly fiduciary on the part of counsel, and he may do nothing which restricts the right of the client to repose confidence in any counsel of his choice. No concept of the practice of law is more deeply rooted.

We therefore conclude that the doctor-patient relationship is special and entitled to unique protection. It cannot be easily or accurately compared to relationships in the commercial context. In light of the great public policy interest involved in covenants not to compete between physicians, each agreement will be strictly construed for reasonableness.

Reasonableness is a fact-intensive inquiry that depends on the totality of the circumstances. A restriction is unreasonable and thus will not be enforced: (1) if the restraint is greater than necessary to protect the employer’s legitimate interest; or (2) if that interest is outweighed by the hardship to the employee and the likely injury to the public. Thus, in the present case, the reasonableness inquiry requires us to examine the interests of the employer, employee, patients, and public in general. Balancing these competing interests is no easy task and no exact formula can be used.

VMS contends, and the court of appeals agreed, that it has a protectable interest in its patients and referral sources. In the commercial context, it is clear that employers have a legitimate interest in retaining their customer base. The employer’s

point of view is that the company's clientele is an asset of value which has been acquired by virtue of effort and expenditures over a period of time, and which should be protected as a form of property. In the medical context, however, the personal relationship between doctor and patient as well as the patient's freedom to see a particular doctor, affects the extent of the employer's interest. The practice of a physician is a thing so purely personal, depending so absolutely on the confidence reposed in his personal skill and ability, that when he ceases to exist it necessarily ceases also.

These facts support the trial judge's conclusion that VMS's interest in protecting its patient base was outweighed by other factors.

[Moreover,] the restriction cannot be greater than necessary to protect VMS's legitimate interests. A restraint's scope is defined by its duration and geographic area. The frequency of contact between doctors and their patients affects the permissible length of the restraint. The idea is to give the employer a reasonable amount of time to overcome the former employee's loss, usually by hiring a replacement and giving that replacement time to establish a working relationship. When the restraint is for the purpose of protecting customer relationships, its duration is reasonable only if it is no longer than necessary for the employer to put a new man on the job and for the new employee to have a reasonable opportunity to demonstrate his effectiveness to the customers.

In this case, the trial judge found that the three-year period was an unreasonable duration because

all of the experts agree that the practice of pulmonology entails treating patients with chronic conditions which require more hospital care than office care and which requires regular contact with the treating physician at least once within each six-month period so that any provision over six months is onerous and unnecessary to protect VMS's economic interests where virtually all of Dr. Farber's VMS patients had an opportunity by late 1994 or early 1995 (Farber left September 12, 1994) to decide which pulmonologist . . . they would consult for their ongoing treatment[.]

On this record, we cannot say this factual finding was clearly erroneous. The three-year duration is unreasonable.

The court of appeals held that the restrictive covenant does not violate public policy, pointing out that the record contains nothing to suggest there will be a lack of pulmonologists in the restricted area if Dr. Farber is precluded from practicing there. Even if we assume other pulmonologists will be available to cover Dr. Farber's patients, we disagree with this view. It ignores the significant interests of individual patients within the restricted area. A court must evaluate the extent to which

enforcing the covenant would foreclose patients from seeing the departing physician if they desire to do so.

Concluding that patients' right to see the doctor of their choice is entitled to substantial protection, VMS's protectable interests here are comparatively minimal. The geographic scope of this covenant encompasses approximately 235 square miles, making it very difficult for Dr. Farber's existing patients to continue treatment with him if they so desire. After six days of testimony, the trial judge concluded that this restrictive covenant was unreasonably broad and against public policy. Given the facts and the principles discussed, that finding is well supported factually and legally.

This contract contains a severance clause.² The court of appeals accepted a stipulation by VMS that the restriction would not prohibit Dr. Farber from treating HIV-positive and AIDS patients or from performing brachytherapy. On its face, however, the restriction is broader than that, restricting him from providing "medical care or medical assistance for any person or persons who were patients or [sic] Employer during the period that Employee was in the hire of Employer." Arizona courts will "blue pencil" restrictive covenants, eliminating grammatically severable, unreasonable provisions. Here, however, the modifications go further than cutting grammatically severable portions. The court of appeals, in essence, rewrote the agreement in an attempt to make it enforceable. This goes too far. Where the severability of the agreement is not evident from the contract itself, the court cannot create a new agreement for the parties to uphold the contract.

Even the blue pencil rule has its critics. For every agreement that makes its way to court, many more do not. Thus, the words of the covenant have an *in terrorem* effect on departing employees. Employers may therefore create ominous covenants, knowing that if the words are challenged, courts will modify the agreement to make it enforceable. Although we will tolerate ignoring severable portions of a covenant to make it more reasonable, we will not permit courts to add terms or rewrite provisions.

We hold that the restrictive covenant between Dr. Farber and VMS cannot be enforced. Valley Medical Specialists' interest in enforcing the restriction is outweighed by the likely injury to patients and the public in general.

² [By the court: The severance clause in the Agreement provides:] Since it is the agreement and desire of the parties hereto that the provisions of this Paragraph 17 be enforced to the fullest extent possible under the laws and public policies applied in each jurisdiction in which enforcement is sought, should any particular provision of this Paragraph 17 be deemed invalid or unenforceable, the same shall be deemed reformed and amended to delete herefrom that portion thus adjudicated invalid, and the deletion shall apply only with respect to the operation of said provision and, to the extent a provision of this Paragraph 17 would be deemed unenforceable by virtue of its scope, but may be made unenforceable by limitation thereof, each party agrees that this Agreement shall be reformed and amended so that the same shall be enforceable to the fullest extent permissible under the laws and public policies applied in the jurisdiction in which enforcement is sought, the parties hereto acknowledging that the covenants contained in this Paragraph 17 are an indispensable part of the transactions contemplated herein.

Review Question 3. Suppose you are a transactional attorney hired by Valley Medical Specialists following this case. How might you rewrite the covenant-not-to-compete terms quoted in the case to improve the chances that an Arizona court would enforce them? Consult section 188 of the Second Restatement in connection with answering this question. Incidentally, what exactly is the “blue pencil rule” and how might it impact the way you draft non-competition provisions?

Review Question 4. The *Valley Medical Specialists* court notes that an “ominous” and unenforceable covenant not to compete may have “an *in terrorem* effect on departing employees.” What does that mean? Do attorneys—who like doctors are government-licensed professionals with public obligations—drafting a contract have any ethical or moral obligation to not include contract terms that they know to be unenforceable? Why or why not?

BATSAKIS v. DEMOTSIS

Court of Civil Appeals of Texas—El Paso
226 S.W.2d 673 (Tex. Civ. App. 1949)

McGILL, J.

Plaintiff sued defendant to recover \$2,000 with interest at the rate of 8% per annum from April 2, 1942, alleged to be due on the following instrument, being a translation from the original, which is written in the Greek language:

Peiraeus
April 2, 1942
Mr. George Batsakis
Konstantinou Diadohou #7
Peiraeus

Mr. Batsakis:

I state by my present (letter) that I received today from you the amount of two thousand dollars (\$2,000.00) of United States of America money, which I borrowed from you for the support of my family during these difficult days and because it is impossible for me to transfer dollars of my own from America.

The above amount I accept with the expressed promise that I will return to you again in American dollars either at the end of the present war or even before in the event that you might be able to find a way to collect them (dollars) from my representative in America to whom I shall write and give him an order relative to

this. You understand until the final execution (payment) to the above amount an eight per cent interest will be added and paid together with the principal.

I thank you and I remain yours with respects.

The recipient,

(Signed) Eugenia The. Demotsis.

Trial to the court without the intervention of a jury resulted in a judgment in favor of plaintiff for \$750.00 principal, and interest at the rate of 8% per annum from April 2, 1942 to the date of judgment, totaling \$1,163.83, with interest thereon at the rate of 8% per annum until paid. Plaintiff has perfected his appeal.

[Defendant] avers that on or about April 2, 1942 she owned money and property and had credit in the United States of America, but was then and there in the Kingdom of Greece in straitened financial circumstances due to the conditions produced by World War II and could not make use of her money and property and credit existing in the United States of America. That in the circumstances the plaintiff agreed to and did lend to defendant the sum of 500,000 drachmae, which at that time, on or about April 2, 1942, had the value of \$25.00 in money of the United States of America. That the said plaintiff, knowing defendant's financial distress and desire to return to the United States of America, exacted of her the written instrument plaintiff sues upon, which was a promise by her to pay to him the sum of \$2,000.00 of United States of America money.

Defendant testified that she did receive 500,000 drachmas from plaintiff. It is not clear whether she received all the 500,000 drachmas or only a portion of them before she signed the instrument in question. Her testimony clearly shows that the understanding of the parties was that plaintiff would give her the 500,000 drachmas if she would sign the instrument. She testified:

Q. Who suggested the figure of \$2,000.00?

A. That was how he asked me from the beginning. He said he will give me five hundred thousand drachmas provided I signed that I would pay him \$2,000.00 American money.

The transaction amounted to a sale by plaintiff of the 500,000 drachmas in consideration of the execution of the instrument sued on, by defendant. It is not contended that the drachmas had no value. Indeed, the judgment indicates that the trial court placed a value of \$750 on them or on the other consideration which plaintiff gave defendant for the instrument if he believed plaintiff's testimony. Therefore the plea of want of consideration was unavailing. A plea of want of consideration amounts to a contention that the instrument never became a valid obligation in the first place. *National Bank of Commerce v. Williams*, 84 S.W.2d 691 (Tex. 1935).

Mere inadequacy of consideration will not void a contract. 10 TEX. JUR., *Contracts* § 89 at 150; *Chastain v. Texas Christian Missionary Society*, 78 S.W.2d 728 (Tex. Civ. App. 1935).

Defendant got exactly what she contracted for according to her own testimony. The court should have rendered judgment in favor of plaintiff against defendant for the principal sum of \$2,000.00 evidenced by the instrument sued on, with interest as therein provided. We construe the provision relating to interest as providing for interest at the rate of 8% per annum. The judgment is reformed so as to award appellant a recovery against appellee of \$2,000.00 with interest thereon at the rate of 8% per annum from April 2, 1942. Such judgment will bear interest at the rate of 8% per annum until paid on \$2,000.00 thereof and on the balance interest at the rate of 6% per annum. As so reformed, the judgment is affirmed.

Review Question 5. Hang on. The *Batsakis* case is a discussion of consideration. Didn't we already cover that? Why on earth did your casebook authors include this case here and now?

Review Question 6. In April 1941, the Axis powers (led by Nazi Germany) had occupied Greece. Estimates are that some 300,000 people died of starvation in Athens during the occupation. April 1942—when Demotsis asked Batsakis for money—was perhaps the high-water mark for the Axis. Much of the American fleet had been destroyed at Pearl Harbor; England was still suffering bombing raids; the Philippines and much of southeast Asia had fallen to the Japanese; hundreds of American merchant ships were being sunk right off the country's coasts; German troops had captured Kiev, encircled Leningrad, and reached the outskirts of Moscow; British troops in North Africa were retreating back to Egypt and their Mediterranean supply lines were in a shambles. In that context, Eugenia Demotsis borrowed the value of \$25 in exchange for a promise to pay George Batsakis \$2,000 "plus interest." If we generally believe in freedom of contract, what possible problems are there with Batsakis reaping the benefit of a shrewd business deal?

Review Question 7. Before you read the next case, *Williams v. Walker-Thomas Furniture Co.*, read section 2-302 of the Uniform Commercial Code. Imagine you are a judge with a strong "textualist" view of statutory interpretation—i.e., you believe that the meaning of a statute should be predominantly or exclusively derived from its enacted text and not its legislative history (such as the UCC Official Comments). If you were tasked with resolving a claim that a particular contract was "unconscionable," how would you determine what the term means?

WILLIAMS v. WALKER-THOMAS FURNITURE CO.

United States Court of Appeals for the District of Columbia Circuit
121 U.S. App. D.C. 315, 350 F.2d 445 (1965)

J. SKELLY WRIGHT, Circuit Judge

Appellee, Walker-Thomas Furniture Company, operates a retail furniture store in the District of Columbia. During the period from 1957 to 1962 each appellant in these cases purchased a number of household items from Walker-Thomas, for which payment was to be made in installments. The terms of each purchase were contained in a printed form contract which set forth the value of the purchased item and purported to lease the item to appellant for a stipulated monthly rent payment. The contract then provided, in substance, that title would remain in Walker-Thomas until the total of all the monthly payments made equaled the stated value of the item, at which time appellants could take title. In the event of a default in the payment of any monthly installment, Walker-Thomas could repossess the item.

The contract further provided that “the amount of each periodical installment payment to be made by [purchaser] to the Company under this present lease shall be inclusive of and not in addition to the amount of each installment payment to be made by [purchaser] under such prior leases, bills or accounts; and *all payments now and hereafter made by [purchaser] shall be credited pro rata on all outstanding leases, bills and accounts due the Company by [purchaser] at the time each such payment is made.*” (Emphasis added.) The effect of this rather obscure provision was to keep a balance due on every item purchased until the balance due on all items, whenever purchased, was liquidated. As a result, the debt incurred at the time of purchase of each item was secured by the right to repossess all the items previously purchased by the same purchaser, and each new item purchased automatically became subject to a security interest arising out of the previous dealings.

On May 12, 1962, appellant Thorne purchased an item described as a Daveno [sofa], three tables, and two lamps, having total stated value of \$391.10. Shortly thereafter, he defaulted on his monthly payments and appellee sought to replevy all the items purchased since the first transaction in 1958. Similarly, on April 17, 1962, appellant Williams bought a stereo set of stated value of \$514.95.³ She too defaulted shortly thereafter, and appellee sought to replevy all the items purchased since December, 1957. The Court of General Sessions granted judgment for appellee. The

³ [By the court] At the time of this purchase her account showed a balance of \$164 still owing from her prior purchases. The total of all the purchases made over the years in question came to \$1,800. The total payments amounted to \$1,400.

District of Columbia Court of Appeals affirmed, and we granted appellants' motion for leave to appeal to this court.⁴

Appellants' principal contention, rejected by both the trial and the appellate courts below, is that these contracts, or at least some of them, are unconscionable and, hence, not enforceable. In its opinion, the District of Columbia Court of Appeals explained its rejection of this contention as follows:

Appellant's second argument presents a more serious question. The record reveals that prior to the last purchase appellant had reduced the balance in her account to \$164. The last purchase, a stereo set, raised the balance due to \$678. Significantly, at the time of this and the preceding purchases, appellee was aware of appellant's financial position. The reverse side of the stereo contract listed the name of appellant's social worker and her \$218 monthly stipend from the government. Nevertheless, with full knowledge that appellant had to feed, clothe and support both herself and seven children on this amount, appellee sold her a \$514 stereo set.

We cannot condemn too strongly appellee's conduct. It raises serious questions of sharp practice and irresponsible business dealings. A review of the legislation in the District of Columbia affecting retail sales and the pertinent decisions of the highest court in this jurisdiction disclose, however, no ground upon which this court can declare the contracts in question contrary to public policy. We note that were the Maryland Retail Installment Sales Act, or its equivalent, in force in the District of Columbia, we could grant appellant appropriate relief. We think Congress should consider corrective legislation to protect the public from such exploitive contracts as were utilized in the case at bar.

We do not agree that the court lacked the power to refuse enforcement to contracts found to be unconscionable. In other jurisdictions, it has been held as a matter of common law that unconscionable contracts are not enforceable.⁵ While no decision of this court so holding has been found, the notion that an unconscionable bargain should not be given full enforcement is by no means novel. In *Scott v. United States*, 79 U.S. 443 (1870), the Supreme Court stated:

⁴ [In 1970, Congress made the D.C. Court of Appeals the highest court in the District, equivalent to a state supreme court. Like the highest courts of other states, determinations of state (or District) law are final, and appeals related to federal or constitutional issues now go directly to the U.S. Supreme Court. Prior to that date, the D.C. Court of Appeals acted as a mid-level appellate court whose decisions were appealed to the D.C. Circuit. – Eds.]

⁵ [By the court] *Campbell Soup Co. v. Wentz*, 172 F.2d 80 (3d Cir. 1948); *Indianapolis Morris Plan Corp. v. Sparks*, 172 N.E.2d 899 (Ind. Ct. App. 1961); *Henningsen v. Bloomfield Motors, Inc.*, 161 A.2d 69 (N.J. 1960).

If a contract be unreasonable and unconscionable, but not void for fraud, a court of law will give to the party who sues for its breach damages, not according to its letter, but only such as he is equitably entitled to.

Since we have never adopted or rejected such a rule, the question here presented is actually one of first impression.

Congress has recently enacted the Uniform Commercial Code,⁶ which specifically provides that the court may refuse to enforce a contract which it finds to be unconscionable at the time it was made. 28 D.C. Code § 2-302 (Supp. IV 1965). The enactment of this section, which occurred subsequent to the contracts here in suit, does not mean that the common law of the District of Columbia was otherwise at the time of enactment, nor does it preclude the court from adopting a similar rule in the exercise of its powers to develop the common law for the District of Columbia. In fact, in view of the absence of prior authority on the point, we consider the congressional adoption of § 2-302 persuasive authority for following the rationale of the cases from which the section is explicitly derived. Accordingly, we hold that where the element of unconscionability is present at the time a contract is made, the contract should not be enforced.

Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party. Whether a meaningful choice is present in a particular case can only be determined by consideration of all the circumstances surrounding the transaction. In many cases the meaningfulness of the choice is negated by a gross inequality of bargaining power. The manner in which the contract was entered is also relevant to this consideration. Did each party to the contract, considering his obvious education or lack of it, have a reasonable opportunity to understand the terms of the contract, or were the important terms hidden in a maze of fine print and minimized by deceptive sales practices? Ordinarily, one who signs an agreement without full knowledge of its terms might be held to assume the risk that he has entered a one-sided bargain. But when a party of little bargaining power, and hence little real choice, signs a commercially unreasonable contract with little or no knowledge of its terms, it is hardly likely that his consent, or even an objective manifestation of his consent, was ever given to all the terms. In such a case the usual rule that the terms of the agreement are not to be questioned should be abandoned and the court should consider whether the terms of the contract are so unfair that enforcement should be withheld.

⁶ [Be careful not to misunderstand Judge Wright's statement that "Congress . . . enacted the Uniform Commercial Code." The UCC, as you have previously learned, is *state* law, not national law. This action by Congress was in its Constitutionally-enumerated power to govern the District of Columbia. Thus, it was effectively enacting state-like law for Washington D.C. Congress did *not* enact the UCC as federal law for the United States. – Eds.]

In determining reasonableness or fairness, the primary concern must be with the terms of the contract considered in light of the circumstances existing when the contract was made. The test is not simple, nor can it be mechanically applied. The terms are to be considered “in the light of the general commercial background and the commercial needs of the particular trade or case.” Corbin suggests the test as being whether the terms are “so extreme as to appear unconscionable according to the mores and business practices of the time and place.” 1 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 128 (1963). We think this formulation correctly states the test to be applied in those cases where no meaningful choice was exercised upon entering the contract.

Because the trial court and the appellate court did not feel that enforcement could be refused, no findings were made on the possible unconscionability of the contracts in these cases. Since the record is not sufficient for our deciding the issue as a matter of law, the cases must be remanded to the trial court for further proceedings.

So ordered.

Arthur Allen Leff, *Unconscionability and the Code: The Emperor’s New Clause*, 115 U. PA. L. REV. 485 (1967):

Let us begin the story the way so many good stories begin, with ritual incantation: to make a contract one needs (i) parties with capacity, (ii) manifested assent, and (iii) consideration. This is all very simple. If these criteria are met, a party to the resulting nexus who has made promises is obligated to carry them out, unless he can maintain successfully one of the standard contract-law defenses, such as fraud, duress, mistake, impossibility or illegality. These “defenses” might be classified in divers ways to serve various analytical purposes. For our particular needs, however, there is a simple way of grouping them which is signally illuminating: some of these defenses have to do with the *process of contracting* and others have to do with the resulting *contract*. When fraud and duress are involved, for instance, the focus of attention is on what took place between the parties at the making of the contract. With illegality, on the other hand, the material question is instead the content of the contract once “made.” The law may legitimately be interested both in the way agreements come about and in what they provide. A “contract” gotten at gunpoint may be avoided; a classic dicker over Dobbin may come to naught if horse owning is illegal. Hereafter, to distinguish the two interests, I shall often refer to bargaining naughtiness as “procedural unconscionability,” and to evils in the resulting contract as “substantive unconscionability.”

If reading [UCC § 2-302] makes anything clear it is that reading this section alone makes nothing clear about the meaning of “unconscionable” except perhaps that it is pejorative. More particularly, one cannot tell from the statute whether the key concept is something to be predicated on the bargaining process or on the bargain or on some combination of the two, that is, to use our terminology, whether it is procedural or substantive. Nonetheless, determining whether the section’s target is a species of quasi-fraud or quasi-duress, or whether it is a species of quasi-illegality, is obviously the key to the bite and scope of the provision.

[The author discusses the drafting history of UCC § 2-302 and the Comments to it, noting that over time they grew less and less precise with respect to what the term “unconscionable” meant.]

The draftsmen [ultimately] were faced with several possibilities. They could have said that if a certain level of bargaining elaborateness were reached, any resulting contract (short of illegality) would be invulnerable to later judicial meddling. That, however, would most likely have necessitated some fuller description of what type of bargaining procedure was envisioned as sufficiently immunizing. This, as the earliest draft itself showed, presented exceedingly difficult drafting problems. Alternatively, the draftsmen could have espoused the position that there were some contractual provisions, presently unspecifiable, which could not be permitted under the Code no matter how fully bargained between the parties. This position, however, might well have been unacceptable to important backers of the Code (not to mention to legislatures) if it had been set forth in high relief. Thus faced with a dilemma, the difficulty of the first alternative and the unpopularity of the second, the draftsmen opted for a third solution. They fudged.

Review Question 8. Professor Leff’s article has been enormously influential in defining the somewhat nebulous concept of unconscionability. Almost all discussions of contractual unconscionability today rely on his “procedural” and “substantive” categorizations. Most jurisdictions require both procedural and substantive unconscionability. Some use a sliding scale where having more of one means less of the other is needed. Some states have even taken the position that if the substantive unfairness is great enough, then only it is required. Can you explain to your classmates (and professor) Professor Leff’s argument as to what the two prongs of unconscionability are and how they are distinct?

Problems

Problem 16.1

The California Talent Agencies Act requires that any “talent agency”—which means “a person or corporation who engages in the occupation of procuring, offering, promising, or attempting to procure employment or engagements for an artist or artists”—obtain a license from the state. “Artist” under the statute includes actors and actresses. The statute requires licensed talent agencies to meet certain experience qualifications, adhere to certain standards, maintain client trust funds, to post bonds, and disclose their fee schedules. It also provides that any contract with an unlicensed agent for these “talent agency” services is void as a matter of law.

There is a distinction, however, between *agents* who procure employment for their clients, who must be licensed, and *managers* who counsel, advise, handle investments, and help artists develop their careers. Managers do *not* have to be licensed.

Actress is an aspiring television and film performer. She enters into a “Personal Management Agreement” with Manager. Under the agreement Manager is to provide personal and career counseling and representation to Actress in all aspects of her career. He is to receive 5 percent of all income she makes from television, film, radio, and other media. The contract runs for 5 years.

Manager becomes actively involved in Actress’s career, making suggestions, helping her meet the right people, even loaning her money at times, although in the first year of the contract she earns very little and Manager gets virtually no income from her. At the beginning of the second year of the contract, Manager becomes aware that Giant Studios is casting *Deep Six*, a new undercover crime drama, and that it is looking for “new faces.” Manager has a longstanding relationship with his next-door neighbor, the producer of the new series, and lobbies heavily to get Actress the lead role in the show. Although the studio is initially uninterested, the producer finally agrees to test her, and Actress eventually gets the part, based primarily on the work that Manager has done.

The series becomes a huge hit. Actress wins a Golden Globe, is nominated for an Emmy, and becomes a household name whose every move makes tabloid headlines. Giant Studios announces plans to make a *Deep Six* theatrical film, in which Actress will star. Her original salary for the TV series—originally \$25,000 per episode—is quickly boosted to \$200,000, and her fee for the film will be \$15 million.

Manager plays no part in the actual negotiation of the contracts, which are handled by a licensed talent agency.

After signing the film contract, Actress tells manager she will not pay manager any part of the income received from the *Deep Six* series and film because he was operating as an unlicensed talent agent and therefore her contract with him is void. She immediately signs a new management contract with a new manager. Manager sues, claiming his commissions for all of her television and film earnings for the five-year period.

Problem 16.2

Employee, a veterinarian licensed in Texas, enters into a contract of employment on with Employer. Also a licensed veterinarian, Employer owns and operates two animal clinics in the Dallas-Fort Worth (DFW) area. Employer hires Employee to manage and to provide veterinary services at his Pethouse Pet Clinic in Arlington, Texas. (Employer himself manages a second animal clinic in Plano, Texas, about 40 miles away.) At the time Employee is hired, the Pethouse clinic has been in operation for 15 years and has a large and stable customer base. Employee has moved from Amarillo—where his own practice had not been terribly successful—to take the job. The contract provides Employee with a base salary, plus a bonus based on the profitability of the Pethouse Pet Clinic. The contract provides that either party may terminate the agreement upon 120 days' notice to the other party. The written employment contract also contains the following provisions:

Voluntary Termination. (a) Employee agrees that upon his voluntary termination of the Employee-Employer relationship, Employee will not practice veterinary medicine in Arlington, Texas or within a ten (10) mile radius of the Pethouse Pet Clinic in Arlington [which is 1007 North Cooper Street, Arlington, Texas] for a period of three (3) years.

(b) Employee agrees not to advertise within the City of Arlington his departure from the Pethouse Pet Clinic or send any written announcements or announcements of any sort notifying clients that he is leaving the practice of veterinary medicine at the Pethouse Pet Clinic.

(c) Employee further agrees that he will not notify present or past clients of the Pethouse Pet Clinic of new location within three (3) years after his voluntary termination.

Each year the contract is renewed with a change in the compensation scheme, increasing Employee's salary and adding a provision giving him a percentage of the profits. Otherwise, each the new contract is identical to the first, particularly with regard to the noncompete clause.

After practicing at Employer's clinic for five years and becoming popular with Pethouse customers, Employee resigns to go to work for more money at Pethouse's

major competitor, Furry Friends Animal Care. Furry Friends is approximately 2.2 miles from Pethouse Pet Clinic. Employee immediately sends notice of his new position to all of his patients (or, rather, their owners) from Pethouse and Furry Friends takes out advertisements in *Mid-Cities Magazine*, the *Fort Worth Star-Telegram*, and the *Dallas Morning News* –all of which circulate in Arlington, Texas, announcing Employee’s new position with Furry Friends.

Employer sues to enforce the covenant. What are the arguments for and against its enforcement?

Problem 16.3

Latke is a recent immigrant to the United States. He speaks very little English, but gets a job working days as a cleaning person at a hotel, and another washing dishes in the evening at a restaurant. Each week sends a small amount of money back home to his family in Ruritania. One Saturday, Latke, who is a big music fan, goes into Discount Electronics, a retailer. He falls into conversation with a clerk, another Ruritanian immigrant, who speaks fluent Ruritanian. The clerk shows him an excellent music system that can be purchased for \$500 in cash, or can be purchased on a rent-to-own basis at \$12 a week for two years. Latke signs the rent-to-own contract, which is printed in both English and Spanish. Other than the price and the length of the contract, the clerk does not translate any of the terms for Latke, who does not ask for any translation.

The contract provides that Latke can terminate the contract at any time by returning the music system, but Discount will keep all payments previously made. It also provides that if Latke fails to pay but keeps possession of the stereo, all remaining weekly payments are due immediately to Discount and Latke becomes the owner of the music system. Finally, the contract provides that if Discount is required to sue Latke to get its money, Latke will be liable for reasonable collection and attorneys’ fees.

Latke takes the system home and makes payments for more than a year. At this point, the music system breaks down. Latke, who thinks he’s already paid more than the original \$500 selling price, stops making payments, but does not return the music system. Discount brings in a collection agency, which is unable to collect from Latke. It then sues Latke for the 45 remaining payments (\$540), along with \$150 in collection costs and \$750 in attorneys’ fees for filing the suit. In this jurisdiction, attorneys’ fees in contract cases are only recoverable if they are provided for in the contract.

Latke defends arguing that the contract is unconscionable. What are the arguments for and against a finding of unconscionability in this case? As this case involves a sale of goods, be sure to use UCC § 2-302 in your analysis.



AMERICAN CONTRACT LAW FOR A GLOBAL AGE

Chapter VI: Terms and Interpretation

Unit 17: The Parol Evidence Rule

Unit 18: The Interpretive Toolbox

Unit 19: Conditions

Unit 20: Implied Terms

An Introduction to TERMS AND INTERPRETATION

Having determined that an enforceable agreement exists and that none of the contract defenses apply, we turn to what is, from a transactional perspective at least, the most important part of the Contracts course, the question of *what exactly does the contract require?* Along with issues of damages, raised later in these materials, the interpretation of contract language is probably litigated more often than any other issues. One federal judge remarked that by a rough estimate about 80 percent of the breach-of-contract cases before him involved disputes over the meaning of terms.

An Imperfect Tool? Language by and large is a reasonably good tool for conveying meaning. But it is not perfect. Most contracts are clear enough that no one has concerns with what they mean. If your apartment lease requires payment every first of the month and prohibits pets, we will most of the time understand what it means. Most contracts are routinely performed without any dispute between the parties. But when a problem arises in a contract, it is very often due to the fact that the parties simply do not agree as to what they were supposed to do. Only after we have decided on what the *terms* of the agreement are, and what obligations the parties have assumed, can we determine whether one of the parties has breached.

Even in carefully written contracts, disputes can arise over what particular language means. And when contracts are oral—and have to be reconstructed from unreliable memories by biased litigants months or years after the events occurred—there is even more chance of misunderstanding.

Interpretation . . . and Managing It at the Outset. Lawyers and judges in general use much the same interpretive tool kit that ordinary humans do in ordinary life—what exactly was said, how was it said, what was the context in which it was said, what other people mean when they say the same thing, what the parties did after it was said, and so on. Lawyers who draft and litigate contracts develop two great but almost opposite skills: (1) the ability to craft language that says exactly what the parties meant to say, and (2) the ability to develop alternative interpretations of language that seems on its face to be plain.

Interpretation, however, includes much more than simply determining what the language means. The law itself puts certain obligations on contracting parties. Some of these can be changed or eliminated by agreement memorialized by careful drafting, but some of them cannot. Moreover, on many issues that come up in contract litigation the parties never actually discussed the issue. If you agree to purchase Burge's car, for example, the two of you may never discuss whether Burge is obliged to deliver it to you, or you are obliged to pick it up from him. In these cases the law (especially the UCC) often provides "default" terms that become part of the contract. Every contract thus contains far more terms than the ones the parties have actually

discussed. What those terms are and how parties deal with them is an important part of this discussion.

In this part of the book, we will take the issues of interpretation in four phases. First, we explore the role of the writing in situations where all or part of the agreement is written. Under what circumstances can parties argue that other terms are also part of the agreement? This is the topic lawyers call the “parol evidence rule.” Second, once we have determined what language the parties have used, we must determine what it means. We sometimes call this the lawyer’s interpretive “tool kit.” Third, we explore terms that may be in the contract even though the parties did not discuss them and one or both parties would have objected to them. These are known as “implied terms.” And fourth, we explore the issue of when certain promises (historically called “covenants” need not be performed because they are subject to trigger mechanisms that we call “conditions.”

For transactional lawyers, this is the area where you can do your clients a great deal of good by avoiding misunderstandings through careful drafting. For litigators, it is the place where you will exercise your skill and ingenuity to the utmost.

Unit 17: The Parol Evidence Rule

TERMS AND INTERPRETATION Part One

FOCUS OF THIS UNIT

Written Contracts with Oral Terms? Contracts come in many forms. Some are simple and oral. Some are complex and written. Some involve both oral and written terms. If a contract is completely written out and intended by the parties to be the expression of their final deal—a complex, negotiated merger deal between multinational corporations, for example—the natural tendency is to rely solely on the writing. On the other hand, if there is no writing at all, oral testimony or other evidence is necessary to prove the nature of the deal. But what about situations where some parts of the deal are in writing and some are not?

You have experienced this directly. When you buy something at a local store and sign a receipt, there is a writing that shows at least the price of the item. But most of the other terms of the deal—can you carry it out or will it be delivered, what warranty does it carry, can it be returned to the store, and so forth—will either have been discussed orally or not discussed at all. If the goods turn out to be defective, you will have a contract and there will be a writing evidencing it—but all the rest of the terms will have to be supplied by oral testimony or other evidence—categories that the law traditionally calls “parol evidence.”

Parol is for Contracts; Parole is for Convicts. The word “parol” —*please* note the lack of a final “e”¹ so you can avoid looking silly to other lawyers—is a French term for “oral.” Nonetheless, parol evidence as used in contract law does not solely mean “oral” evidence, it means *any* evidence other than what is in the written contract itself. Thus written documents that are not the contract document can be “parol” evidence to the same extent as oral testimony.

¹ [The English word “parole,” despite its different meaning, is also related to the French word for “oral.” The term in criminal law came from the oral promises that soldiers or prisoners would make to their captors if they were released, such as a promise not to engage in future hostilities, or to act on good behavior, hence being “out on parole.” Now that you know the difference, we beg you not to embarrass us by referring to a “parole evidence rule” in contract law. No such thing exists.—Eds.]

Given that certain cases involve both a written agreement *and* parol evidence that tries to contradict or supplement the written agreement, an important question arises as to how much credit to give the writing. To what extent can a party try to prove that a contract means something very different from a written document? Are parties bound by what they sign, or are they free to claim that the contract is something else entirely?

The Rule. To deal with these issues, English common law over the years developed what came to be known as the “parol evidence rule,” under which oral agreements that seem to conflict with a writing the parties have adopted will be refused enforcement. It rests on at least two assumptions. The first assumption is that what the parties did at the time of the contract—that is, what they wrote and signed—is likely to be better evidence of what their actual deal was than is their subsequent self-serving testimony. The second assumption is that litigation is expensive and parties should be able to rely on written agreements. If the written contract requires delivery by August 15, for example, but one party now wants to argue that the parties really intended delivery “any time so long as it is before Christmas,” the parol evidence starts with the assumption that what the parties wrote at the time is more likely to be the “true” agreement as to the delivery date than what one party now claims—after a dispute has developed—the parties really intended. Both the legal system and contracting parties benefit if they can know for certain that “by August 15” means “by August 15” rather than “any time so long as it is before Christmas.” Neither courts nor parties will then spend time, effort, and money litigating over the issue.

Downsides to the Rule. Even if we grant these two assumptions, situations arise in which enforcing the terms of a written agreement can result in injustice. It would be absurd, for example, to prohibit a party who signed an agreement at gunpoint from being able to prove the gunman’s threats merely because the contract says, “The parties are entering this agreement freely and not under compulsion.” Similarly, if two parties agree to the sale of a motorcycle totaled in a wreck for \$50, and the parties, intending to write \$50.00 instead write \$5000 (forgetting the decimal) hardly anyone would argue that a court should force the buyer to pay the larger amount. Thus, over the years some exceptions have been crafted to the strict application of the rule. You will meet some in the materials that follow.

Statutory Parol Evidence Rules and Other Variants. While the parol evidence rule arose as a common law innovation, there are various versions embodied in statutes, such as UCC § 2-202. Even beyond the UCC, some states have codified their general rules regarding admissibility of parol evidence, but others have left the rule as a matter of common law. Each jurisdiction’s exceptions to the parol evidence rule have developed more or less independently, creating great variation among the states. Even within a given state, rules can be confusing because courts sometimes

use different words to mean the same thing, and sometimes us the same words to mean different thing. Two states might use the same language but come to different results while two other states might use different language but come to the same result.

You will ultimately find that the parol evidence rule is seldom ironclad. Evidence of prior and contemporaneous parol agreements will sometimes be admitted despite what seems to be a straightforward bar.

Cases and Materials

MITCHILL v. LATH

Court of Appeals of New York
247 N.Y. 377, 160 N.E. 646 (1928)

ANDREWS, J.

In the fall of 1923 the Laths owned a farm. This they wished to sell. Across the road, on land belonging to Lieutenant-Governor Lunn, they had an ice house which they might remove. Mrs. Mitchill looked over the land with a view to its purchase. She found the ice house objectionable. Thereupon “the defendants orally promised and agreed, for and in consideration of the purchase of their farm by the plaintiff, to remove the said ice house in the spring of 1924.” Relying upon this promise, she made a written contract to buy the property for \$8,400, for cash and a mortgage and containing various provisions usual in such papers. Later receiving a deed, she entered into possession and has spent considerable sums in improving the property for use as a summer residence. The defendants have not fulfilled their promise as to the ice house and do not intend to do so. We are not dealing, however, with their moral delinquencies. The question before us is whether their oral agreement may be enforced in a court of equity.

This requires a discussion of the parol evidence rule—a rule of law which defines the limits of the contract to be construed. It is more than a rule of evidence and oral testimony even if admitted will not control the written contract unless admitted without objection. It applies, however, to attempts to modify such a contract by parol. It does not affect a parol collateral contract distinct from and independent of the written agreement. It is, at times, troublesome to draw the line. Williston, in his work on Contracts points out the difficulty. “Two entirely distinct contracts,” he says, “each for a separate consideration may be made at the same time and will be distinct legally. Where, however, one agreement is entered into wholly or partly in consideration of the simultaneous agreement to enter into another, the transactions are necessarily bound together. . . . Then if one of the agreements is oral and the other

is written, the problem arises whether the bond is sufficiently close to prevent proof of the oral agreement.” SAMUEL WILLISTON, *THE LAW OF CONTRACTS* § 637 (1920).

That is the situation here. It is claimed that the defendants are called upon to do more than is required by their written contract in connection with the sale as to which it deals.

The principle may be clear, but it can be given effect by no mechanical rule. As so often happens, it is a matter of degree, for as Professor Williston also says where a contract contains several promises on each side it is not difficult to put any one of them in the form of a collateral agreement. If this were enough, written contracts might always be modified by parol. Not form, but substance is the test.

In applying this test the policy of our courts is to be considered. We have believed that the purpose behind the rule was a wise one not easily to be abandoned. Notwithstanding injustice here and there, on the whole it works for good. Old precedents and principles are not to be lightly cast aside unless it is certain that they are an obstruction under pre-sent conditions. New York has been less open to arguments that would modify this particular rule, than some jurisdictions elsewhere. Thus in *Eighmie v. Taylor*, 98 N. Y. 288 (1885), it was held that a parol warranty might not be shown although no warranties were contained in the writing.

Under our decisions before such an oral agreement as the present is received to vary the written contract at least three conditions must exist: (1) the agreement must in form be a collateral one; (2) it must not contradict express or implied provisions of the written contract; (3) it must be one that parties would not ordinarily be expected to embody in the writing; or put in another way, an inspection of the written contract, read in the light of surrounding circumstances must not indicate that the writing appears “to contain the engagements of the parties, and to define the object and measure the extent of such engagement.” Or again, it must not be so clearly connected with the principal transaction as to be part and parcel of it.

The respondent does not satisfy the third of these requirements. It may be, not the second. We have a written contract for the purchase and sale of land. The buyer is to pay \$8,400 in the way described. She is also to pay her portion of any rents, interest on mortgages, insurance premiums and water meter charges. She may have a survey made of the premises. On their part the sellers are to give a full covenant deed of the premises as described, or as they may be described by the surveyor if the survey is had, executed and acknowledged at their own expense; they sell the personal property on the farm and represent they own it; they agree that all amounts paid them on the contract and the expense of examining the title shall be a lien on the property; they assume the risk of loss or damage by fire until the deed is delivered; and they agree to pay the broker his commissions. Are they to do more? Or is such a claim inconsistent with these precise provisions? It could not be shown that the

plaintiff was to pay \$500 additional. Is it also implied that the defendants are not to do anything unexpressed in the writing?

That we need not decide. At least, however, an inspection of this contract shows a full and complete agreement, setting forth in detail the obligations of each party. On reading it one would conclude that the reciprocal obligations of the parties were fully detailed. Nor would his opinion alter if he knew the surrounding circumstances. The presence of the ice house, even the knowledge that Mrs. Mitchill thought it objectionable would not lead to the belief that a separate agreement existed with regard to it. Were such an agreement made it would seem most natural that the inquirer should find it in the contract. Collateral in form it is found to be, but it is closely related to the subject dealt with in the written agreement—so closely that we hold it may not be proved.

Where the line between the competent and the incompetent is narrow the citation of authorities is of slight use. Each represents the judgment of the court on the precise facts before it. How closely bound to the contract is the supposed collateral agreement is the decisive factor in each case. But reference may be made to *Johnson v. Oppenheim*, 55 N. Y. 280 (1873); *Love v. Hamel*, 69 N.Y.S. 251 (Sup. Ct. App. Div. 1901); *Daly v. Piza*, 94 N.Y.S. 154 (Sup. Ct. App. Div. 1905). *Johnson v. Oppenheim* and the two [cases from] the Appellate Division relate to collateral contracts said to have been the inducing cause of the main contract. All hold that an oral stipulation, said to have been the inducing cause for the subsequent execution of the lease itself, concerning some act to be done by the landlord, or some condition as to the leased premises, might not be shown. In principle they are not unlike the case before us. Attention should be called also to *Taylor v. Hopper*, 62 N. Y. 649 (1875), where it is assumed that evidence of a parol agreement to remove a barn, which was an inducement to the sale of lots, was improper.

We do not ignore the fact that authorities may be found that would seem to support the contention of the appellant. Such are *Erskine v. Adeane*, [1873] LR 8 Exch. 756, and *Morgan v. Griffith* [1871] L. R. 6 Exch. 70, where although there was a written lease a collateral agreement of the landlord to [remove the rabbits that had overrun the field] was admitted. In this State, *Wilson v. Deen*, *supra*, might lead to the contrary result. Neither are they approved in New Jersey. See *Naumberg v. Young*, 44 N.J.L. 331 (1882). A line of cases in Massachusetts, of which *Durkin v. Cobleigh*, 30 N.E. 474 (1892), is an example, have to do with collateral contracts made before a deed is given. But the fixed form of a deed makes it inappropriate to insert collateral agreements, however closely connected with the sale.² Here we deal with

² [As you may have learned in your Property course, the deed is the formal document that actually conveys the property. A real estate contract usually requires a party to provide a deed at the time of closing, but the deed is not the contract itself.—Eds.]

the contract on the basis of which the deed to Mrs. Mitchill was given subsequently, and we confine ourselves to the question whether its terms may be modified.

Our conclusion is that the judgment of the Appellate Division and that of the Special Term should be reversed and the complaint dismissed, with costs in all courts.

LEHMAN, J., dissenting.

I accept the general rule as formulated by Judge Andrews. I differ with him only as to its application to the facts shown in the record. The plaintiff contracted to purchase land from the defendants for an agreed price. A formal written agreement was made between the sellers and the plaintiff's husband. It is on its face a complete contract for the conveyance of the land. It describes the property to be conveyed. It sets forth the purchase price to be paid. All the conditions and terms of the conveyance to be made are clearly stated. I concede at the outset that parol evidence to show additional conditions and terms of the conveyance would be inadmissible. There is a conclusive presumption that the parties intended to integrate in that written contract every agreement relating to the nature or extent of the property to be conveyed, the contents of the deed to be delivered, the consideration to be paid as a condition precedent to the delivery of the deeds, and indeed all the rights of the parties in connection with the land. The conveyance of that land was the subject-matter of the written contract and the contract completely covers that subject.

The parol agreement which the court below found the parties had made was collateral to, yet connected with, the agreement of purchase and sale. It has been found that the defendants induced the plaintiff to agree to purchase the land by a promise to remove an ice house from land not covered by the agreement of purchase and sale. No independent consideration passed to the defendants for the parol promise. To that extent the written contract and the alleged oral contract are bound together. The same bond usually exists wherever attempt is made to prove a parol agreement which is collateral to a written agreement. Hence "the problem arises whether the bond is sufficiently close to prevent proof of the oral agreement."

Judge Andrews has formulated a standard to measure the closeness of the bond. Three conditions, at least, must exist before an oral agreement may be proven to increase the obligation imposed by the written agreement. I think we agree that the first condition that the agreement "must in form be a collateral one" is met by the evidence. I concede that this condition is met in most cases where the courts have nevertheless excluded evidence of the collateral oral agreement. The difficulty here, as in most cases, arises in connection with the two other conditions.

The second condition is that the "parol agreement must not contradict express or implied provisions of the written contract." Judge Andrews voices doubt whether this condition is satisfied. The written contract has been carried out. The purchase

price has been paid; conveyance has been made, title has passed in accordance with the terms of the written contract. The mutual obligations expressed in the written contract are left unchanged by the alleged oral contract. When performance was required of the written contract, the obligations of the parties were measured solely by its terms. By the oral agreement the plaintiff seeks to hold the defendants to other obligations to be performed by them thereafter upon land which was not conveyed to the plaintiff. The assertion of such further obligation is not inconsistent with the written contract unless the written contract contains a provision, express or implied, that the defendants are not to do anything not expressed in the writing. Concededly there is no such express provision in the contract, and such a provision may be implied, if at all, only if the asserted additional obligation is "so clearly connected with the principal transaction as to be part and parcel of it," and is not "one that the parties would not ordinarily be expected to embody in the writing." The hypothesis so formulated for a conclusion that the asserted additional obligation is inconsistent with an implied term of the contract is that the alleged oral agreement does not comply with the third condition as formulated by Judge Andrews. In this case, therefore, the problem reduces itself to the one question whether or not the oral agreement meets the third condition.

I have conceded that upon inspection the contract is complete. "It appears to contain the engagements of the parties, and to define the object and measure the extent of such engagement;" it constitutes the contract between them and is presumed to contain the whole of that contract. *Eighmie v. Taylor*, 98 N. Y. at 294-95. That engagement was on the one side to convey land; on the other to pay the price. The plaintiff asserts further agreement based on the same consideration to be performed by the defendants after the conveyance was complete, and directly affecting only other land. It is true, as Judge Andrews points out, that "the presence of the ice house, even the knowledge that Mrs. Mitchill thought it objectionable, would not lead to the belief that a separate agreement existed with regard to it;" but the question we must decide is whether or not, assuming an agreement was made for the removal of an unsightly ice house from one parcel of land as an inducement for the purchase of another parcel, the parties would ordinarily or naturally be expected to embody the agreement for the removal of the ice house from one parcel in the written agreement to convey the other parcel. Exclusion of proof of the oral agreement on the ground that it varies the contract embodied in the writing may be based only upon a finding or presumption that the written contract was intended to cover the oral negotiations for the removal of the ice house which lead up to the contract of purchase and sale. To determine what the writing was intended to cover "the document alone will not suffice. What it was intended to cover cannot be known till we know what there was to cover. The question being whether certain subjects of negotiation were intended to be covered, we must compare the writing and the negotiations before we can determine whether they were in fact covered." JOHN HENRY WIGMORE, A TREATISE ON THE SYSTEM OF EVIDENCE IN TRIALS AT COMMON LAW § 2430 (2d. ed. 1923).

The subject-matter of the written contract was the conveyance of land. The contract was so complete on its face that the conclusion is inevitable that the parties intended to embody in the writing all the negotiations covering at least the conveyance. The promise by the defendants to remove the ice house from other land was not connected with their obligation to convey, except that one agreement would not have been made unless the other was also made. The plaintiff's assertion of a parol agreement by the defendants to remove the ice house was completely established by the great weight of evidence. It must prevail unless that agreement was part of the agreement to convey and the entire agreement was embodied in the writing.

The fact that in this case the parol agreement is established by the overwhelming weight of evidence is, of course, not a factor which may be considered in determining the competency or legal effect of the evidence. Hardship in the particular case would not justify the court in disregarding or emasculating the general rule. It merely accentuates the outlines of our problem. The assumption that the parol agreement was made is no longer obscured by any doubts. The problem then is clearly whether the parties are presumed to have intended to render that parol agreement legally ineffective and non-existent by failure to embody it in the writing. Though we are driven to say that nothing in the written contract which fixed the terms and conditions of the stipulated conveyance suggests the existence of any further parol agreement, an inspection of the contract, though it is complete on its face in regard to the subject of the conveyance, does not, I think, show that it was intended to embody negotiations or agreements, if any, in regard to a matter so loosely bound to the conveyance as the removal of an ice house from land not conveyed.

The rule of integration undoubtedly frequently prevents the assertion of fraudulent claims. Parties who take the precaution of embodying their oral agreements in a writing should be protected against the assertion that other terms of the same agreement were not integrated in the writing. The limits of the integration are determined by the writing, read in the light of the surrounding circumstances. A written contract, however complete, yet covers only a limited field. I do not think that in the written contract for the conveyance of land here under consideration we can find an intention to cover a field so broad as to include prior agreements, if any such were made, to do other acts on other property after the stipulated conveyance was made.

In each case where such a problem is presented, varying factors enter into its solution. Citation of authority in this or other jurisdictions is useless, at least without minute analysis of the facts. The analysis I have made of the decisions in this State leads me to the view that the decision of the courts below is in accordance with our own authorities and should be affirmed.

Review Question 1. Judge Lehman begins his dissent stating that he essentially agrees with Judge Andrews regarding the substance of the legal rules at issue in the case. Why exactly do the two judges reach different results while ostensibly following the same law?

Review Question 2. Judge Andrews thinks that removing the ice house was something that the parties naturally would have included in the written contract. Judge Lehman disagrees. Who do you think is correct and why? And what exactly do the judges mean when they refer to agreements as being “collateral”?

Review Question 3. Read through sections 209-213 of the Restatement (Second) of Contracts. Would the buyers’ evidence in *Mitchill* be excluded under the Restatement approach? Now consider the exceptions to the parol evidence rule stated in sections 214-218. Which exceptions, if any, might apply in a case like *Mitchill*?

MASTERSON v. SINE

Supreme Court of California

68 Cal. 2d 222, 436 P.2d 561, 65 Cal. Rptr. 545 (1968)

TRAYNOR, C.J.

[Dallas Masterson and his wife Rebecca owned a ranch. They sold the ranch to Dallas’s sister Medora and her husband Lu Sine. In the deed, Dallas and Rebecca (the “grantors”) reserved an option to repurchase the property. Dallas went bankrupt. Rebecca and Dallas’s trustee sought to exercise the option to purchase the land (whose price had presumably increased) and pay off creditors. Dallas tried to testify that the option given to Medora and Lu was personal to him—that is, that he had no legal right to assign it to anyone else—and therefore it did not pass to his estate. The trial court excluded the testimony under the parol evidence rule.]

When the parties to a written contract have agreed to it as an “integration”—a complete and final embodiment of the terms of an agreement—parol evidence cannot be used to add to or vary its terms. When only part of the agreement is integrated, the same rule applies to that part, but parol evidence may be used to prove elements of the agreement not reduced to writing.

The crucial issue in determining whether there has been an integration is whether the parties intended their writing to serve as the exclusive embodiment of their agreement. The instrument itself may help to resolve that issue. It may state, for example, that “there are no previous understandings or agreements not contained in the writing,” and thus express the parties’ “intention to nullify antecedent

understandings or agreements.” 3 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 578 at 411 (1960). Any such collateral agreement itself must be examined, however, to determine whether the parties intended the subjects of negotiation it deals with to be included in, excluded from, or otherwise affected by the writing. Circumstances at the time of the writing may also aid in the determination of such integration.

In formulating the rule governing parol evidence, several policies must be accommodated. One policy is based on the assumption that written evidence is more accurate than human memory. This policy, however, can be adequately served by excluding parol evidence of agreements that directly contradict the writing. Another policy is based on the fear that fraud or unintentional invention by witnesses interested in the outcome of the litigation will mislead the finder of facts. McCormick has suggested that the party urging the spoken as against the written word is most often the economic underdog, threatened by severe hardship if the writing is enforced. In his view the parol evidence rule arose to allow the court to control the tendency of the jury to find through sympathy and without a dispassionate assessment of the probability of fraud or faulty memory that the parties made an oral agreement collateral to the written contract, or that preliminary tentative agreements were not abandoned when omitted from the writing. CHARLES T. MCCORMICK, EVIDENCE § 210 (1954).

Evidence of oral collateral agreements should be excluded only when the fact finder is likely to be misled. The rule must therefore be based on the credibility of the evidence. One such standard, adopted by section 240(1)(b) of the [First] Restatement of Contracts, permits proof of a collateral agreement if it “is such an agreement as might naturally be made as a separate agreement by parties situated as were the parties to the written contract.” The draftsmen of the Uniform Commercial Code would exclude the evidence in still fewer instances: “If the additional terms are such that, if agreed upon, they would certainly have been included in the document in the view of the court, then evidence of their alleged making must be kept from the trier of fact.” UCC § 2-202, cmt. 3.

The option clause in the deed in the present case does not explicitly provide that it contains the complete agreement, and the deed is silent on the question of assignability. Moreover, the difficulty of accommodating the formalized structure of a deed to the insertion of collateral agreements makes it less likely that all the terms of such an agreement were included. The statement of the reservation of the option might well have been placed in the recorded deed solely to preserve the grantors’ rights against any possible future purchasers, and this function could well be served without any mention of the parties’ agreement that the option was personal. There is nothing in the record to indicate that the parties to this family transaction, through experience in land transactions or otherwise, had any warning of the disadvantages of failing to put the whole agreement in the deed. This case is one, therefore, in which

it can be said that a collateral agreement such as that alleged “might naturally be made as a separate agreement.” *A fortiori*, the case is not one in which the parties “would certainly” have included the collateral agreement in the deed.

It is contended, however, that an option agreement is ordinarily presumed to be assignable if it contains no provisions forbidding its transfer or indicating that its performance involves elements personal to the parties. *Mott v. Cline*, 253 P. 718 (Cal. 1927). The fact that there is a written memorandum, however, does not necessarily preclude parol evidence rebutting a term that the law would otherwise presume.

In the present case defendants offered evidence that the parties agreed that the option was not assignable in order to keep the property in the Masterson family. The trial court erred in excluding that evidence.

The judgment is reversed.

BURKE, J., dissenting.

I dissent. The majority opinion:

(1) Undermines the parol evidence rule as we have known it in this state since at least 1872 by declaring that parol evidence should have been admitted by the trial court to show that a written option, absolute and unrestricted in form, was intended to be limited and nonassignable;

(2) Renders suspect instruments of conveyance absolute on their face;

(3) Materially lessens the reliance which may be placed upon written instruments affecting the title to real estate; and

(4) Opens the door, albeit unintentionally, to a new technique for the defrauding of creditors.

The opinion permits defendants to establish by parol testimony that their grant to their brother (and brother-in-law) of a written option, absolute in terms, was nevertheless agreed to be nonassignable by the grantee (now a bankrupt), and that therefore the right to exercise it did not pass, by operation of the bankruptcy laws, to the trustee for the benefit of the grantee’s creditors.

And how was this to be shown? By the proffered testimony of the bankrupt optionee himself! Thereby one of his assets (the option to purchase defendants’ California ranch) would be withheld from the trustee in bankruptcy and from the bankrupt’s creditors. Understandably the trial court, as required by the parol evidence rule, did not allow the bankrupt by parol to so contradict the unqualified language of the written option.

[In this case,] the grantor husband (the bankrupt businessman) testified that as none of the parties were attorneys “we wanted to contact my attorney . . . which we did. . . . The wording in the option was obtained from [the attorney]. . . . I told him what my discussion was with the Sines [defendant grantees] and he wanted . . . a

little time to compose it And, then this [the wording provided by the attorney] was taken to the title company at the time Mr. and Mrs. Sine and I went in to complete the transaction.” The witness was an experienced businessman who thus demonstrated awareness of the wisdom of seeking legal guidance and advice in this business transaction, and who did so. Wherein lies the naïve family transaction postulated by the majority?

I would hold that the trial court ruled correctly on the proffered parol evidence, and would affirm the judgment.

Review Question 4. The so-called “collateral agreement” exception to the parol evidence rule recognizes the reality that parties may actually have multiple, separate contracts between themselves. Thus, assuming that all agreements between the parties were merged into the most recent one could undermine the parties’ actual intent to have separate contracts. How should courts balance the collateral agreement exception recognized by the *Masterson* majority with the bad-faith concerns expressed by the dissent? Is it possible to accommodate both problems, or must we simply choose among the lesser of two evils?

Review Question 5. *Masterson* is a case involving real property. But suppose it was instead a sale of goods, like the family’s luxury yacht. Carefully read UCC § 2-202? Would a case like *Masterson* come out the same way if section 2-202 applied? Why or why not?

Review Question 6. You might be interested to know that Karl Llewellyn, the chief drafter of Article 2, was not a fan of the parol evidence rule and would have gotten rid of it entirely if other drafters (backed by the merchant representatives who were on the drafting committee) had permitted him to do so. Do you get the sense from *Masterson* that Chief Justice Traynor might also not have cared for the parol evidence rule? What reasons would famous legal minds like Llewellyn and Traynor possibly have for disliking the parol evidence rule? What reasons would merchants have for liking it?

NELSON v. ELWAY
Supreme Court of Colorado
908 P.2d 102 (Colo. 1995)

VOLLACK, C.J.

[Mel Nelson owned two car dealerships, Metro Auto and Metro Toyota, both of which were in financial difficulty. His business was financed by General Motors

Acceptance Corp. (GMAC), to which Nelson owed \$3 million. Nelson was in default on the debt and thus GMAC had acquired rights to some control over the business, including a veto power over any sale of the dealerships. In 1991, Nelson discussed selling the dealerships John Elway—then the quarterback for the Denver Broncos and the owner of other dealerships—and Rodney Buscher. Nelson wanted more for the dealerships than Elway and Buscher were willing to pay, so the parties orally negotiated a deal (which the court calls the “Service Agreement”) under which the sale price would be dropped and Nelson would get a fee of \$50 per car sold over the ensuing seven years.³

GMAC agreed to approve the sale, but insisted that Nelson not get any of the proceeds of the sale, which would instead go to pay off GMAC. GMAC specifically stated it would not approve the deal if the Service Agreement were in place. Accordingly, the parties went through with the sale at the agreed-upon price without the Service Agreement. Nelson later testified that Elway and Buscher both orally promised that even though GMAC had vetoed the Service Agreement, they would honor it by making the \$50-per-car payments to Nelson. When he was not paid, he sued.]

The issue with regard to the breach of contract claim is whether the merger clauses in the Buy-Sell Agreements precluded the consideration of evidence that the parties intended the Service Agreement to be part of the overall agreement to sell the dealerships.⁴

We agree that the merger clauses preclude consideration of extrinsic evidence to ascertain the intent of the parties. Integration clauses generally allow contracting parties to limit future contractual disputes to issues relating to the express provisions of the contract. Therefore, the terms of a contract intended to represent a final and complete integration of the agreement between the parties are enforceable, and extrinsic evidence offered to prove the existence of prior agreements is inadmissible. *Sentinel Acceptance Corp. v. Colgate*, 424 P.2d 380, 382 (Colo. 1967). Even when extrinsic evidence is admissible to ascertain the intent of the parties, such evidence may not be used to demonstrate an intent that contradicts or adds to the intent

³ [This is a common type of agreement in a sale of business case. The seller (Nelson) usually thinks the business is worth more than the buyer (Elway) does. The seller often makes rosy predictions of future sales and bases the price on that. Under this arrangement, the buyer pays a lower price but if it turns out the seller is correct about future sales, the seller gets more money. If the seller turns out to be wrong, the buyer pays less.—Eds.]

⁴ [*By the court:*] Paragraph 14 [i.e., the merger clause] of both of the Buy-Sell Agreements for Metro Toyota and Metro Auto, both signed on March 16, 1991, by Nelson, Elway, and Buscher, states:

This Agreement constitutes the entire Agreement between the parties pertaining to the subject matter contained herein, and supersedes all prior agreements, representations and understandings of the parties. No modification or amendment of this Agreement shall be binding unless in writing and signed by the parties

expressed in the writing. *KN Energy, Inc. v. Great Western Sugar Co.*, 698 P.2d 769, 777 n.9 (Colo. 1985).

In this case, the merger clauses plainly and unambiguously manifest the intent of the parties that the Buy-Sell Agreements executed on March 16, 1991 constitute the entire agreement between the parties pertaining to the subject matter contained therein. Where, as here, sophisticated parties who are represented by counsel have consummated a complex transaction and embodied the terms of that transaction in a detailed written document, it would be improper for this court to rewrite that transaction by looking to evidence outside the four corners of the contract to determine the intent of the parties.

The petitioners and respondents signed the March 16, 1991 Buy-Sell Agreements after extensive negotiation and numerous drafts of documents. By doing so, all parties expressly agreed, pursuant to the merger clauses, that the terms of those Buy-Sell Agreements would control the transaction and that all other agreements, oral or written, would be void. We will not step into a commercial transaction after the fact and attempt to ascertain the intent of the parties when that intent is clearly manifested by an express term in a written document. We thus conclude that the merger clauses in the March 16, 1991, Buy-Sell Agreements are dispositive as to the intent of the parties in this case. As there is no dispute as to any material fact with regard to this issue, the court of appeals correctly affirmed the trial court's order of summary judgment in favor of the respondents on this issue.

LOHR, J., with whom KIRSHBAUM and SCOTT, JJ., dissenting.

I respectfully dissent. Summary judgment is a severe remedy. As the majority notes, in summary judgment proceedings courts must resolve all doubts as to the existence of genuine issues of material fact against the moving party. In view of the record and the procedural posture of this case, I would hold that Nelson's claims were improperly dismissed. The parties disagree as to why Elway did not sign the service agreement. Elway contends that GMAC refused to approve the sale if the service agreement was executed. Nelson, on the other hand, alleges that Pico and Elway prompted GMAC to impose such conditions. Nelson proceeded with the sale of the dealerships because he already had turned control over to GMAC and thereby eliminated a bankruptcy reorganization alternative that was previously under consideration.

Merger clauses preclude consideration of extrinsic evidence only where the parties intend that the document containing the merger is exclusive. *ARB, Inc. v. E-Systems, Inc.*, 663 F.2d 189, 199 (D.C. Cir. 1980). The very essence of this case is a dispute regarding whether the parties intended the service agreement to be part and parcel of the overall deal. Because Nelson's position is adequately supported in the record, the intention of the parties regarding the exclusivity of the document

containing the merger agreement is a disputed issue of material fact. As a result, this case is inappropriate for summary judgment disposition.

The parties' intention that the buy-sell agreements constituted entire contracts, allegedly evidenced by the merger clauses within, was by no means clearly manifested. See *Sierra Diesel Injection Serv. v. Burroughs Corp.*, 874 F.2d 653, 657 (9th Cir. 1989) ("the presence of a merger clause while often taken as a strong sign of the parties' intent is not conclusive in all cases"). In this case, despite the disclaimer in both merger clauses that each buy-sell agreement constituted the entire agreement, the overall deal involved two buy-sell agreements and two real estate contracts. Furthermore, each buy-sell agreement made reference to the real estate contracts despite the exclusivity disclaimer. Regardless of the standard merger and integration language in the buy-sell agreements, it is clear that the parties intended their ultimate bargain to encompass other agreements, although the substantive weight of the alleged service agreement remains unclear.

When the parties disagree as to whether a document expresses the complete agreement of the parties, and a court subsequently finds that the evidence is conflicting or admits of more than one inference, the resolution of the parties' dispute requires a factual determination.

In short, this case is singularly inappropriate for resolution in a summary judgment proceeding.

Review Question 7. As you should have observed, the two contracts discussed by the *Nelson* court contained the following merger clause:

This Agreement constitutes the entire Agreement between the parties pertaining to the subject matter contained herein, and supersedes all prior agreements, representations and understandings of the parties. No modification or amendment of this Agreement shall be binding unless in writing and signed by the parties[.]

What is the basis for the dissent's argument that, in the face of this language, the buy-sell agreements were in fact *not* fully integrated? Put another way, what changes to the facts of the case could have resulted in a unanimous decision that the contracts were, in fact, fully integrated?

Review Question 8. The parol evidence rule is ostensibly designed to increase certainty by allowing parties to rely on the written word. But in *Mitchill*, *Masterson*, and *Nelson*, the judges could not even agree among themselves on whether the rule applied. Can the majority opinions in these three cases be reconciled?

**UNITED NATIONS CONVENTION ON CONTRACTS
FOR THE INTERNATIONAL SALE OF GOODS**

Article 8

(1) For the purposes of this Convention statements made by and other conduct of a party are to be interpreted according to his intent where the other party knew or could not have been unaware what that intent was.

(2) If the preceding paragraph is not applicable, statements made by and conduct of a party are to be interpreted according to the understanding a reasonable person of the same kind as the other party would have had in the same circumstances.

(3) In determining the intent of a party or the understanding a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.

***MCC-MARBLE CERAMIC CENTER, INC. v. CERAMICA NUOVA D'AGOSTINO,
S.P.A.***

United States Court of Appeals for the Eleventh Circuit
144 F.3d 1384 (11th. Cir. 1998), cert. denied, 526 U.S. 1087 (1999)

BIRCH, Circuit Judge.

[Buyer MCC was a tile distributor in the United States. Seller D'Agostino was a tile manufacturer in Italy. Monzon, the president of MCC, met D'Agostino representatives at a trade fair. Through a translator, the parties negotiated a purchase, which was memorialized on one of D'Agostino's standard sales forms. The form set out the price, quality, quantity, delivery, and payment terms. Later, according to Monzon, the parties subsequently entered into a related but separate oral "requirements" contract under which D'Agostino agreed to provide MCC with discounts. Several further orders were placed, each written on a form that did not mention the alleged discount term. D'Agostino made several deliveries, but stopped when MCC refused to pay the invoice amount but demanded the alleged discount. MCC sued D'Agostino for failing to fill several orders. The purchase orders signed by Monzon on behalf of MCC stated that they reflected the entire deal of the two parties. At trial, MCC sought to prove that the parties had the oral side deal with respect to discounts.]

We must address a question of first impression in this circuit: whether the parol evidence rule, which bars evidence of an earlier oral contract that contradicts or varies the terms of a subsequent or contemporaneous written contract, plays any role in cases involving the CISG.

The CISG itself contains no express statement on the role of parol evidence. It is clear, however, that the drafters of the CISG were comfortable with the concept of permitting parties to rely on oral contracts because they eschewed any statutes of fraud provision and expressly provided for the enforcement of oral contracts. Moreover, article 8(3) of the CISG expressly directs courts to give “due consideration . . . to all relevant circumstances of the case including the negotiations . . .” to determine the intent of the parties. Given article 8(1)’s directive to use the intent of the parties to interpret their statements and conduct, article 8(3) is a clear instruction to admit and consider parol evidence regarding the negotiations to the extent they reveal the parties’ subjective intent.

Although jurisdictions in the United States have found the parol evidence rule helpful to promote good faith and uniformity in contract, as well as an appropriate answer to the question of how much consideration to give parol evidence, a wide number of other States Party to the CISG have rejected the rule in their domestic jurisdictions. One of the primary factors motivating the negotiation and adoption of the CISG was to provide parties to international contracts for the sale of goods with some degree of certainty as to the principles of law that would govern potential disputes and remove the previous doubt regarding which party’s legal system might otherwise apply. *See* Letter of Transmittal from Ronald Reagan, President of the United States, to the United States Senate, *reprinted at* 15 U.S.C. app. 70, 71 (1997). Courts applying the CISG cannot, therefore, upset the parties’ reliance on the Convention by substituting familiar principles of domestic law when the Convention requires a different result.

This is not to say that parties to an international contract for the sale of goods cannot depend on written contracts or that parol evidence regarding subjective contractual intent need always prevent a party relying on a written agreement from securing summary judgment. To the contrary, most cases will not present a situation (as exists in this case) in which both parties to the contract acknowledge a subjective intent not to be bound by the terms of a pre-printed writing. In most cases, therefore, article 8(2) of the CISG will apply, and objective evidence will provide the basis for the court’s decision. Consequently, a party to a contract governed by the CISG will not be able to avoid the terms of a contract and force a jury trial simply by submitting an affidavit which states that he or she did not have the subjective intent to be bound by the contract’s terms. Moreover, to the extent parties wish to avoid parol evidence problems they can do so by including a merger clause in their agreement that extinguishes any and all prior agreements and understandings not expressed in the writing.

Review Question 9. “This is not to say,” says the *MCC-Marble* court, “that parties to an international contract for the sale of goods cannot depend on written contracts or that parol evidence regarding subjective contractual intent need always

prevent a party relying on a written agreement from securing summary judgment.” How might a party to a CISG contract help ensure that the writing controls?

Review Question 10. Compare Article 8 of the CISG with UCC section 2-202. Which law is better for a party to a sale of goods who wants to rely solely on a written contract? Which law is better for a party who wants to prove terms outside of a writing?

Problems

Problem 17.1

Thelma agrees to sell her Ford Thunderbird convertible to Louise for \$19,000. The parties orally agree that Louise will pay \$7,000 down, and will pay the remainder in 12 equal payments of \$1,000. The parties draw up a bill of sale. Because the jurisdiction in which they live levies a sales tax and personal property tax on the price of the vehicle, Louise asks Thelma to make the bill of sale out for \$10,000. Thelma agrees. There is no mention of the payment plan in the bill of sale. Both sign the bill of sale, and Louise gives Thelma a check for the \$7,000. Louise makes two monthly \$1,000 payments on the car, but is then killed in a traffic accident. Thelma petitions the estate for the remaining money due on the car, but the estate refuses to pay more than another \$1,000, since the bill of sale is for \$10,000 and Louise had paid \$9,000 before she died. In contesting the claim in the probate court, Thelma wants to introduce evidence that the original deal was for \$19,000. The estate objects to the introduction of Thelma’s testimony. What arguments should each side make as to Thelma’s testimony?

Problem 17.2

International Shoe Co. is an importer and distributor of footwear based in North Carolina. It buys shoes from foreign suppliers and routinely pays in the local currency. To avoid problems with currency fluctuations, International regularly engages in foreign currency futures transactions through Commerce Bank, a large bank headquartered in New York. International sometimes buys currencies and sometimes sells them, depending on the deal that it has entered with a particular customer. On August 1, International enters into a contract to buy \$175,000 worth of luxury footwear from Modo di Roma, an Italian company. The shoes will be delivered and paid for on February 1 of the coming year.

To protect itself from a change in value of the Euro over the six months until February 1, International calls Commerce Bank. International says it agreed to *buy* €175,000, to be delivered on February 1, at an exchange rate of 1.4268 Euros to the

dollar, for the Modo di Roma transaction. The Bank claims that International asked to *sell* €175,000,⁵ and claims that no mention of the Modo di Roma transaction was ever made. Shortly after, Commerce Bank sends a “confirmation” of the trade to International, which states:

WE [THE BANK] HAVE BOUGHT FROM YOU [INTERNATIONAL] EURO 175,000
AND WE HAVE SOLD TO YOU USD 246,690, AT EXCHANGE RATE 1.4268
EUROS PER USD, FOR DELIVERY ON FEBRUARY 1. PLEASE SIGN AND
RETURN THIS CONFIRMATION.

Later that same day, a clerk in International’s office signs the slip and returns it to the Bank. The clerk is willing to testify that he did not notice that the confirmation had the terms exactly reversed—International was *not* selling Euros, it was supposed to be *buying* them.

After a significant drop in the value of the dollar—so that buying Euros was more expensive—International allegedly discovered the error and announced that it was refusing to go through with the transaction. To cover the transaction, the Bank had to go on the open market and buy euros at a higher price, which cost it approximately \$50,000. The Bank has now sued International. International seeks to introduce evidence of the original oral transaction to show that the contract was all a mistake. The Bank opposes such evidence. Can International get its evidence admitted? What should each side argue here?

Problem 17.3

Corvallis Rendering Co. is a plant that turns waste animal tissue into useful products. It purchases scraps from slaughterhouses, animals that have died from natural causes, spoiled meat from grocery stores, carcasses of dead horses and pets from animal shelters, etc., and turns them into valuable products like grease, tallow, and bone meal. One of Corvallis’s biggest suppliers is Oregon Meat Packers, Inc. (OMP), which operates a beef slaughtering and packing house. OMP and Corvallis sign a contract under which OMP will sell all of its scraps and offal to Corvallis. The contract is a detailed agreement which is a standard form supplied by the Oregon State Meat Packing and Rendering Association (of which both Corvallis and OMP are members). It provides a number of terms and includes a merger clause. The contract provides that for each load of material that OMP sends to Corvallis, Corvallis will pay 27¢ per pound “provided that the protein content of the material is at least fifty percent (50%) protein, as tested on delivery at Corvallis’s plant. If the protein content is less than 50%, Corvallis shall pay 24.5¢ per pound.”

⁵ [It is not uncommon for parties to agree to sell currencies or other commodities that they do not own; a party who believes that the Euro will weaken may want to agree to deliver Euros in two months at an exchange rate of, say, 1.5. If the Euro falls, the seller on the delivery date simply buys Euros at the lower rate and pockets the difference as a profit.—Eds.]

When OMP delivers several loads of material that test at 49.5% protein, Corvallis sends a check reflecting the 24.5¢ price. OMP argues that it should have been paid at the higher 27¢ amount, since trade usage in the Oregon rendering trade is that 49.5 percent is always rounded up to 50 percent. Corvallis insists that the parties agreed to the 50% number, not 49.5%. OMP seeks to introduce testimony by its employees of the trade usage. What are the arguments for each side on whether such testimony should be allowed?

Unit 18: The Interpretive Toolbox

TERMS AND INTERPRETATION

Part Two

FOCUS OF THIS UNIT

Issues of formation, consideration, capacity, and defenses all go to the question of whether the parties actually have an enforceable contract. In the great majority of disputes, however, parties agree that they have a contract. They may even agree on the precise text contained in the contract. Their disagreement is on what it means.

Context-Dependent Clarity. Most of the time, words in a contract do not create interpretation disputes. A contract that requires delivery of the British paperback edition of J. K. Rowling’s book *Harry Potter and the Philosopher’s Stone* in exchange for \$8.99 plus \$2.50 shipping and handling means precisely that, and there is very little room for the parties to argue that the parties actually meant Jane Austen’s book *Emma* and that the price was supposed to be \$4.00 with free shipping.

Even when the words themselves are perfectly clear, their meaning can differ substantially based on the context in which they are said or even from tone of voice. We intuitively understand the importance of context and tone even when we do not actively think about such matters. The sarcastic “Noooooo” from a teenager might, in context, mean “Yes, of course, you moron. Duh!” Many words also carry more than one common meaning which may have to be deduced from the context. The word “greens,” for example, will obviously mean something different in a contract that refers to “tees, fairways, roughs, and greens” than it will in a contract that refers to “reds, yellows, blues, and greens.”

Objective or Subjective Meaning? When interpreting contracts, a tension frequently exists between “objective” and “subjective” meanings of certain terms. When two parties have expressed an agreement in words, one approach is simply to enforce what they wrote as the terms would appear to an ordinary reasonable person. You may recall that formation of contracts occurs based on an objective understanding of the parties’ actions. Objective standards value simplicity and predictability. If the parties have used a writing, the plain language of which does not really reflect their actual bargain, then it is the parties’ fault when they do not get the deal they intended, and the solution is to express themselves more clearly in the future.

The alternative approach is to look at the words as merely part of the overall transaction, and to try to determine not what the document says to a reasonable reader, but what the parties subjectively *meant* it to say. The goal in the subjective approach is to carry out the “real” bargain of the parties, which may be different than what they wrote. The benefit, when this approach works correctly, is that the parties get what they really intended. The downside, of course, is the uncertainty inherent in proving subjective meaning.

Subjectivity in Action. Note that if *both* parties agree that the contract’s language is inaccurate and they agree as to what it should be, no problem exists. Courts will always enforce an agreed subjective meaning, and the parties are less likely to have gone to court in the first place. Much more often, however, one party claims that the deal means exactly what was written, and the other party claims that, in the context of their deal, the parties meant something else entirely. The question is not whether the parties’ “real” meaning should control. The question is, rather, *whether we are more likely to find the real meaning in what the parties wrote at the time, or what they now say they meant.*

Since no perfect answer to that question exists and since what two parties “really” meant is impossible to know with complete certainty—even assuming that they both meant the same thing¹—courts and other decisionmakers naturally struggle with interpretation. Given this landscape, a principal goal of transactional lawyers is to do their best to remove possible uncertainties and ambiguities from contracts. Careful drafting can go a long way in avoiding problems. In contrast, contract litigators, who are typically called to service once the parties are already in a dispute, will seek either to exploit or to patch over these uncertainties, depending on their particular client’s position.

The Interpretive Toolbox. When a dispute arises, and a choice of meanings exists, how does the interpreter of a contract choose the “correct” meaning? We all make this sort of judgment dozens of times each day, as we interpret the words people say in light of their context—a handy word encompassing all the surrounding facts that help give words meaning. If the heroine in the romance novel snarls, “I hate you!” at the hero with whom she has been adventuring for the last 200 pages, context may suggest she means something very different from her literal words. We deduce such things from all the circumstances so often that we scarcely realize we are doing it.

Lawyers, of course, are frequently in the business of *convincing* people (e.g., judges, clients, other parties) as to what things mean, and that means that requires

¹ [This assumption is a huge one. The idea that there is some kind of “real” deal between the parties depends on the premise that they meant the same thing at the outset. We have seen the parties sometimes have very different ideas about what they agreed to.—Eds.]

the ability to explain things that many people do subconsciously. Thus over the years a variety of “rules” of interpretation have made their way into the lawyer’s toolbox. They are not really “rules” in the sense that they prescribe conduct to be followed. They are, rather, guidelines for interpreting meaning.

Selecting the Right Tools. If you have spent any substantial time in your law school experience dealing with *statutory* interpretation, you will notice a great deal of methodological overlap with *contract* interpretation. For example, courts often say that when the plain meaning of a contract is evident, they will enforce that plain meaning. You will, however, also see many cases where courts state that they will not allow “blind” or “rigid” adherence to plain meaning to defeat the “true intent” of the parties. If those principles seem directly opposed to each other, that is because they generally are. Such contradictions are not unique to contract (or statutory) interpretation, as paradox seems inherent in the human condition. We have all heard that he who hesitates is lost, but also that it is also best to look before you leap. Likewise, “absence makes the heart grow fonder,” yet one who is “out of sight” is “out of mind.” Both principles are true depending on the particular circumstances. The same is true for our rules of interpretation. Sometimes we will use plain meaning and sometimes we will very nearly ignore the plain meaning.

To get a sense of the interpretive rules used by courts, read sections 200 through 203 of the Restatement (Second) of Contracts. You will, for example, find the traditional plain meaning rule nestled within section 202.

Case Roadmap. The cases in this unit will take you through several important issues involved in contract interpretation. The first two, *W.W.W. Associates* and *Estate of Soper*, illustrate the deceptively titled “plain meaning” rule. Precisely when is meaning plain enough that we do not look past what the words say? *PPG v. Shell* takes up the issue of grammar and its importance in interpretation. Tropes in writing such as the joke about the difference between “Let’s eat, Grandpa!” and “Let’s eat Grandpa!” are actually not that far off the mark; a missing comma or a grammatical error can be costly. What about ambiguous terms, where language is inherently susceptible to multiple plausible meanings? The *Frigaliment* decision, famously known in law school circles as the “chicken case,” is literally a textbook example of how to deal with ambiguity. Finally, the *Random House* case illustrates a problem increasingly relevant in the 21st century: What happens when technology changes while old contract boilerplate terms do not?

Cases and Materials

W.W.W. ASSOCIATES, INC. v. GIANCONTIERI

Court of Appeals of New York

77 N.Y.2d 157, 566 N.E.2d 639, 565 N.Y.S.2d 440 (1990)

KAYE, J.

[This was a dispute over the sale of a parcel of land. The parties signed a form Contract of Sale, supplemented by several additional provisions. One of them (“paragraph 31”) read:

The parties acknowledge that Sellers have been served with process instituting an action concerned with the real property which is the subject of this agreement. In the event the closing of title is delayed by reason of such litigation it is agreed that closing of title will in a like manner be adjourned until after the conclusion of such litigation provided, *in the event such litigation is not concluded, by or before 6-1-87 either party shall have the right to cancel this contract whereupon the down payment shall be returned and there shall be no further rights hereunder.*

Also in the contract was a merger clause:

All prior understandings and agreements between seller and purchaser are merged in this contract [and it] completely expresses their full agreement. It has been entered into after full investigation, neither party relying upon any statements made by anyone else that are not set forth in this contract.

The litigation in fact was not concluded by June 1, and the defendant sellers refused to go forward. The purchaser sued, arguing that the clause in italics had been added for its benefit and it had been understood that only the purchaser could use the clause to back out of the deal. The plaintiff purchaser had provided evidentiary facts in support of its position.]

Defendants made no response to these factual assertions. Rather, its summary judgment motion rested entirely on the language of the Contract of Sale, which it argued was, under the law, determinative of its right to cancel.

The trial court granted defendants’ motion and dismissed the complaint, holding that the agreement unambiguously conferred the right to cancel on defendants as well as plaintiff. The Appellate Division, however, reversed and, after searching the record and adopting the facts alleged by plaintiff in its affidavit, granted summary judgment to plaintiff directing specific performance of the contract. We now reverse and dismiss the complaint.

Critical to the success of plaintiff's position is consideration of the extrinsic evidence that paragraph 31 was added to the contract solely for its benefit. The Appellate Division made clear that this evidence was at the heart of its decision.

We conclude, however, that the extrinsic evidence tendered by plaintiff is not material. In its reliance on extrinsic evidence, plaintiff ignores a vital first step in the analysis: before looking to evidence of what was in the parties' minds, a court must give due weight to what was in their contract.

A familiar and eminently sensible proposition of law is that, when parties set down their agreement in a clear, complete document, their writing should as a rule be enforced according to its terms. Evidence outside the four corners of the document as to what was really intended but unstated or misstated is generally inadmissible to add to or vary the writing. *See, e.g., Mercury Bay Boating Club v San Diego Yacht Club*, 557 N.E.2d 87 (N.Y. 1990). That rule imparts "stability to commercial transactions by safeguarding against fraudulent claims, perjury, death of witnesses, infirmity of memory, [and] the fear that the jury will improperly evaluate the extrinsic evidence." EDITH L. FISCH, *NEW YORK EVIDENCE* § 42 at 22 (2d ed 1987). Such considerations are all the more compelling in the context of real property transactions, where commercial certainty is a paramount concern.

Whether or not a writing is ambiguous is a question of law to be resolved by the courts. *Van Wagner Advertising Corp. v S & M Enterprises*, 492 N.E.2d 756 (N.Y. 1986). In the present case, the contract, read as a whole to determine its purpose and intent, plainly manifests the intention that defendants, as well as plaintiff, should have the right to cancel after June 1, 1987 if the litigation had not concluded by that date; and it further plainly manifests the intention that all prior understandings be merged into the contract, which expresses the parties' full agreement.

Thus, we conclude there is no ambiguity as to the cancellation clause in issue, read in the context of the entire agreement, and that it confers a reciprocal right on both parties to the contract.

The question next raised is whether extrinsic evidence should be considered in order to create an ambiguity in the agreement. That question must be answered in the negative. It is well settled that "extrinsic and parol evidence is not admissible to create an ambiguity in a written agreement which is complete and clear and unambiguous upon its face." *Intercontinental Planning v Daystrom, Inc.*, 248 N.E.2d 576 (N.Y. 1969).

Here, sophisticated businessmen reduced their negotiations to a clear, complete writing. In the paragraphs immediately surrounding paragraph 31, they expressly bestowed certain options on the purchaser alone, but in paragraph 31 they chose otherwise, explicitly allowing both buyer and seller to cancel in the event the litigation was unresolved by June 1, 1987. By ignoring the plain language of the contract, plaintiff effectively rewrites the bargain that was struck. An analysis that

begins with consideration of extrinsic evidence of what the parties meant, instead of looking first to what they said and reaching extrinsic evidence only when required to do so because of some identified ambiguity, unnecessarily denigrates the contract and unsettles the law.

Accordingly, the Appellate Division order should be reversed, with costs, defendants' motion for summary judgment granted, and the complaint dismissed.

Review Question 1. Notice that the *W.W.W. Associates* case is resolved on summary judgment, meaning (in typical summary judgment language) that the court determined there was “no genuine issue of material fact” and that defendant sellers were “entitled to judgment as a matter of law.” How can that possibly be right when the *only* evidence of what the parties meant by the words of the contract was filed by the plaintiff? If anyone wins the case on summary judgment, shouldn't it be the plaintiff who actually had interpretive evidence?

IN RE ESTATE OF SOPER
Supreme Court of Minnesota
196 Minn. 60, 264 N.W. 427 (1935)

JULIUS J. OLSON, J.

Ira Soper married Adeline Westphal in 1911. They lived in Louisville, and had three daughters. In 1921, Soper faked his own suicide and disappeared, abandoning his wife and children. Soper changed his name to John Young, moved to Minneapolis, went into business, and eventually married Gertrude Whitby, a marriage that was bigamous because his marriage to Adeline had never ended. Soper/Young prospered, and took out an insurance policy which provided that the money should be paid on his death to “the wife of the deceased [insured] if living.” When he died, the insurance company paid the money to Gertrude. Adeline discovered the facts, and she and Soper/Young's executor sued to recover the money. Adeline's theory was that, in law, she was the only lawful “wife of the deceased” and thus was entitled to the money. Gertrude argued that Soper/Young had *intended* for her to have the money, not Adeline.]

Gertrude neither did nor could take anything as the “wife” of Young.² As a matter of law she never became such. But this conclusion does not solve our problem because she does not lay claim to the insurance merely as his lawful wife, but as the person intended to be the beneficiary under the escrow agreement as fully as if her name had been written into that contract instead of the word “wife.” Plaintiffs claim that the written instrument is free from ambiguity, latent or otherwise, and that as such it was improper for the trial court to permit oral evidence to show who was intended thereby to be such beneficiary. They strenuously assert that the agreement is not subject to construction, that it is perfectly plain in its language, and that the only thing for the court to determine is whether Mrs. Soper was the lawful wife of the deceased husband or if Gertrude was such.

From the facts and circumstances hereinbefore related the conclusion seems inescapable that Gertrude was intended. She was the only one known or considered by the contracting parties. True, Young knew otherwise, but that he did not intend his real wife to take anything as beneficiary seems obvious. From the time he left Louisville and came to Minneapolis, and until some time after his death, no one amongst his business or social acquaintances knew anything of or concerning his true wife. Gertrude alone answered the descriptive designation of “wife.” Public records disclosed her and her alone to be such. There was no one else.

The question of identification of the individual intended by the written instrument very often involves and requires oral proof. That is the situation here. The right to the money here involved is claimed by both Adeline Soper and Gertrude Young. In what manner may either establish relationship to the decedent as his “wife” except by means of oral testimony? Ira Collins Soper and John W. Young, in the absence of proof *contra*, would likely lead an inquirer to the view that two different men were involved. Adeline, to establish her relationship, was necessarily required to and did furnish proof, principally oral, that her husband, Ira Collins Soper, was in fact the same individual as John W. Young. Gertrude by similar means sought to establish her claim. Of course the proof was such as to require a finding sustaining Adeline’s claim. No one questions that result. But until such proof was adduced it is equally clear, both from public records in Hennepin county and general repute, that Gertrude had been duly married to John W. Young. All friends and acquaintances knew and recognized her as his wife. There was nothing in Minneapolis or in this state indicating otherwise. Were we to award the insurance fund to plaintiff Adeline, it is obvious that we would thereby be doing violence to the contract entered into by the decedent Young with his associate [the insurance agent] Mr. Karstens. That agreement points to no one else than Gertrude as Young’s “wife.” To hold otherwise is to give the word “wife” “a fixed symbol,” as “something inherent

² [That is, Gertrude was not a lawful wife because Soper/Young was already married, and so she could not inherit under Minnesota law. Adeline was the lawful spouse and heir.—Eds.]

and objective, not subjective and personal.” Dean Wigmore in his excellent work on evidence, has this to say:

The ordinary standard, or “plain meaning,” is simply the meaning of the people who did not write the document. The fallacy consists in assuming that there is or ever can be someone real or absolute meaning. In truth, there can be only some person’s meaning; and that person, whose meaning the law is seeking, is the writer of the document.

The truth is that whatever virtue and strength lies in the argument for the antique rule leads not to a fixed rule of law, but only to a general maxim of prudent discretion. In the felicitous alliteration of that great judge, Lord Justice Bowen, it is “not so much a canon of construction as a counsel of caution.”

5 JOHN HENRY WIGMORE, WIGMORE ON EVIDENCE § 2462 at 378-79 (2 ed. 1923).

In *Wilmot v. Minneapolis Automobile Trade Assn.*, 210 N.W. 861 (Minn. 1926), this court said:

The duty of courts is to apply contracts to their subject matter and so effect the purpose of the parties. Their interpretation is incidental. To accomplish the main object resort may and frequently must be had to the circumstances under which the contract was made and, if there be need for resort to extraneous aids to construction, it is immaterial whether such need arises from an uncertainty in the instrument itself or, that being clear standing alone, it ceases to be so and ambiguity arises when the contract is applied to its subject matter. In either case construction must follow and resort must be had to the aids furnished by extrinsic circumstances.

After all, as we said in *City of Marshall v. Gregoire*, 259 N.W. 377, 381-382 (Minn. 1935):

A written contract is little more than a scrap of writing save as it operates with legal effect on matters extraneous to itself. Construction deals with the dynamic rather than the static phase of the instrument. The question is not just what words mean literally but how they are intended to operate practically on the subject matter. Thus, seemingly plain language becomes susceptible of construction, and frequently requires it, if ambiguity appears when attempt is made to operate the contract.

That is the situation here. The trust agreement has become “susceptible of construction” because “ambiguity appears when attempt is made to operate the contract.”

The order is affirmed.

I. M. OLSEN, J., dissenting.³

I am unable to agree that this court should make a new contract for the parties and so change either the policy or the trust agreement as to substitute a new beneficiary. A man can have only one wife. Much is said in the opinion as to the wrong done to the innocent woman whom he purported to marry. Nothing is said about the wrong done to the lawful wife.

The contract in this case designates the “wife” as the one to whom the money was to be paid. I am unable to construe this word to mean anyone else than the only wife of Soper then living.

Review Question 2. If, in the abstract, you read the word “wife” in an insurance policy, would you believe that it had a plain meaning? If the term *does* have a plain meaning, then what business does the court have in construing the contract any other way?

Review Question 3. The *W.W.W. Enterprises* court says that it is improper to look at extrinsic evidence to determine whether a term is “ambiguous.” The *Soper* court seems to say that it is practically inevitable to do so. Can the cases be reconciled, or are we just looking at two different judicial philosophies? Incidentally, are the purported ambiguities in these two cases “latent” or are they “patent”? Why might the category of ambiguity involved matter?

PPG INDUSTRIES, INC. v. SHELL OIL CO.

United States District Court for the Eastern District of Louisiana
727 F. Supp. 285 (E.D. La. 1989)

HENRY A. MENTZ, U.S.D.J.

On May 3, 1983, Shell and PPG entered into a contract for the sale of ethylene by Shell to PPG. On May 5, 1988, an explosion occurred at the Shell oil refinery in Norco, Louisiana. As a result of that explosion, Shell reduced the quantity of ethylene being delivered to PPG. Thereafter, on May 2, 1989, PPG instituted the present suit

³ [Dissenting Justice Ingerval M. Olsen was not related to majority-opinion Justice Julius J. Olsen, although both were born in Norway. Julius Olsen was appointed to the Supreme Court by Governor Floyd Olsen, who was no relation to either, but was also Norwegian. In Minnesota, apparently, life imitates *A Prairie Home Companion*.—Eds.]

against Shell. PPG claims that Shell breached its contract by failing to deliver the specified quantities of ethylene following the Norco explosion. PPG seeks to recover its economic losses allegedly suffered as a result of Shell's inability to perform under the contract.

A federal court sitting in diversity must apply the choice of law principles of the forum state. Thus, this Court is bound to apply the Louisiana choice of law rules. Absent strong public policy considerations, Louisiana allows parties to stipulate in their contracts which state's law are to govern them.

In the instant case, section 13 of the contract in question specifies that Texas law will govern the interpretation of the contract. No showing has been made that applying Texas law would violate any strong public policy considerations. Accordingly, Texas law controls PPG's breach of contract claim.

Under Texas law, interpretation of an unambiguous contract is a question of law. A determination of ambiguity is reserved to the Court.

The contract between PPG and Shell contained an "excuses for nonperformance" clause. Section 8 of the contract reads:

EXCUSES FOR NONPERFORMANCE

Either Seller or Buyer will be excused from the obligations of this Contract to the extent that performance is delayed or prevented by any circumstances (except financial) *reasonably beyond its control or by fire, explosion, mechanical breakdown, strikes or other labor trouble, plant shutdown, unavailability of raw materials or unavailability of or interference with the usual means of transporting the Product or compliance with any law, regulation, order, recommendation, or request of any governmental authority.*

(Emphasis added.)

PPG maintains that the phrase "reasonably beyond its control" qualifies the rest of the contract clause, making the exculpation of Shell dependent upon whether the explosion was reasonably beyond its control. However, under the law of Texas, contract language should be given its "plain grammatical meaning." Simply stated, "or" is disjunctive, or alternative in its effect. *Lyons v. Montgomery*, 701 S.W.2d 641, 643 (Tex. 1985). In other words, "or" means or, not "and." However, PPG argues that the Court is required to determine whether reading "or" as disjunctive would defeat the intentions of the parties, and whether the context requires the Court to determine if a conjunctive meaning is more appropriate. PPG misconstrues Texas law. These inquiries are necessary only if the Court were to determine as a matter of law that the contract language is ambiguous. *See Board of Insurance Comm'rs v. Guardian Life Ins. Co.*, 180 S.W.2d 906 (Tex. 1944). If that were the case, only then would the Court use the two-step inquiry suggested by PPG in order to determine whether there was a genuine issue of material fact with respect to the parties intentions, and

whether any compelling reasons existed for using the conjunctive “or.” However, as noted previously, this Court finds that there is no genuine issue of material fact regarding the plain language of the contract. As a matter of law the contract is unambiguous. “Or” is disjunctive and, therefore, Shell is exculpated under Section 8 of the contract, because of the explosion, regardless of whether the explosion was “reasonably beyond its control.” See *Eastern Airlines, Inc. v. McDonnell Douglas Corp.*, 532 F.2d 957, 992 (5th Cir. 1976). This is not an absurd result, as suggested by PPG, because commercially it would make no sense for Shell to intentionally blow up its own refinery in order to avoid delivering ethylene to PPG. Indeed, it would not make commercial sense for Shell to intentionally bring about any of the contingencies enumerated in Section 8 of the contract.

As noted previously, PPG contends that the term “reasonably beyond its control” modifies the enumerated events which follow “or” in Section 8 of the contract. This interpretation is not in keeping with the plain grammatical meaning of the disjunctive. However, there are cases in this circuit which apply a conjunctive meaning to such a clause. Although, [in these cases,] it is important to note, the “reasonably beyond its control” language follows and clearly modifies by reference the enumerated contingencies. In *Jon-T Chemicals, Inc. v. Freeport Chemical Co.*, 704 F.2d 1412, 1414 (5th Cir. 1983), the excuse clause read in pertinent part:

Seller shall not be liable for any failure or delay in performance hereunder which may be due, in whole or in part, to fire, explosion, earthquake, storm, flood, drought . . . or any contingency or delay or failure or cause of any nature beyond the reasonable control of Seller, whether or not of the kind hereinabove specified. . . .

In *Nissho-Iwai Co., Ltd. v. Occidental Crude Sales*, 729 F.2d 1530 (5th Cir. 1984), the “*force majeure*” clause excused nonperformance caused by:

executive or administrative orders or acts [of the Libyan Government], . . . or by breakdown or injury to . . . producing . . . or delivering facilities, . . . or by any other event, whether or not similar to the causes specified above . . . , which shall not reasonably be within the control of the party against whom the claim would otherwise be made

In these two cases, the reasonable control language and the enumerated events are plainly and grammatically tied together. However, in Section 8 of the Shell-PPG contract these same two portions are not tied together conjunctively, and should not now be read that way. The language is clear and unambiguous. There is no genuine issue of material fact regarding the wording of the contract, particularly Section 8 of the contract. Therefore, Shell is entitled to a judgment as a matter of law.

Review Question 4. The *PPG Industries* court puts a great deal of emphasis on grammar. Note the clause at issue in this case and compare it to the two clauses quoted from the earlier *Jon-T Chemicals* and *Nissho-Iwai* decisions. Can you

describe exactly why the court found the differences in the particular language to be compelling?

Review Question 5. What is a *force majeure* clause and what does it do? That, incidentally, is the sort of thing lawyers in all types of practice are expected to understand as part of their general knowledge.

FRIGALIMENT IMPORTING CO. v. B.N.S. INTERNATIONAL SALES CORP.

United States District Court for the Southern District of New York
190 F. Supp. 116 (S.D.N.Y. 1960)

FRIENDLY, J.:⁴

The issue is, what is chicken? Plaintiff says “chicken” means a young chicken, suitable for broiling and frying. Defendant says “chicken” means any bird of that genus that meets contract specifications on weight and quality, including what it calls “stewing chicken” and plaintiff pejoratively terms “fowl.” Dictionaries give both meanings, as well as some others not relevant here. Assuming that both parties were acting in good faith, the case nicely illustrates Holmes’s remark “that the making of a contract depends not on the agreement of two minds in one intention, but on the agreement of two sets of external signs—not on the parties’ having meant the same thing but on their having said the same thing.” Oliver Wendell Holmes, Jr., *The Path of the Law*, 10 Harv. L. Rev. (1897). I have concluded that plaintiff has not sustained its burden of persuasion that the contract used “chicken” in the narrower sense.

The action is for breach of the warranty that goods sold shall correspond to the description. Two contracts are in suit. In the first, dated May 2, 1957, defendant, a New York sales corporation, confirmed the sale to plaintiff, a Swiss corporation, of

US Fresh Frozen Chicken, Grade A, Government Inspected, Eviscerated 2½-3 lbs. and 1½-2 lbs. each all chicken individually wrapped in cryovac, packed in secured fiber cartons or wooden boxes, suitable for export

75,000 lbs	2 1/2-3 lbs. . . .	“ \$33.00
25,000 lbs.	1 1/2 -2 lbs. . . .	“ \$36.50

per 100 lbs. FAS New York

⁴ [This was Henry J. Friendly, actually a Second Circuit Court of Appeals judge who had been appointed to the appellate bench year before but had no prior judicial experience. He had been a commercial lawyer and in-house counsel at Pan American Airways. Judge Friendly was voluntarily presiding over some trials in district court to see what they were like, and this opinion was one of the results of his endeavor. – Eds.]

scheduled May 10, 1957 pursuant to instructions from Penson & Co., New York.

The second contract, also dated May 2, 1957, was identical save that only 50,000 lbs. of the heavier “chicken” were called for, the price of the smaller birds was \$37 per 100 lbs., and shipment was scheduled for May 30. When the initial shipment arrived in Switzerland, plaintiff found, on May 28, that the 2½-3 lbs. birds were not young chicken suitable for broiling and frying but stewing chicken or “fowl”; indeed, many of the cartons and bags plainly so indicated. Protests ensued. Nevertheless, shipment under the second contract was made on May 29, the 2½-3 lbs. birds again being stewing chicken. Defendant stopped the transportation of these at Rotterdam.

This action followed. Plaintiff says that, notwithstanding that its acceptance was in Switzerland, New York law controls; defendant does not dispute this, and relies on New York decisions. I shall follow the apparent agreement of the parties as to the applicable law.

Since the word “chicken” standing alone is ambiguous, I turn first to see whether the contract itself offers any aid to its interpretation. Plaintiff says the 1½-2 lbs. birds necessarily had to be young chicken since the older birds do not come in that size, hence the 2½-3 lbs. birds must likewise be young. This is unpersuasive—a contract for “apples” of two different sizes could be filled with different kinds of apples even though only one species came in both sizes. Defendant notes that the contract called not simply for chicken but for “US Fresh Frozen Chicken, Grade A, Government Inspected.” It says the contract thereby incorporated by reference the Department of Agriculture’s regulations, which favor its interpretation; I shall return to this after reviewing plaintiff’s other contentions.

The first hinges on an exchange of cablegrams which preceded execution of the formal contracts. The negotiations leading up to the contracts were conducted in New York between defendant’s secretary, Ernest R. Bauer, and a Mr. Stovicek, who was in New York for the Czechoslovak government at the World Trade Fair. A few days after meeting Bauer at the fair, Stovicek telephoned and inquired whether defendant would be interested in exporting poultry to Switzerland. Bauer then met with Stovicek, who showed him a cable from plaintiff dated April 26, 1957, announcing that they “are buyer” of 25,000 lbs. of chicken 2½-3 lbs. weight, Cryovac packed, grade A Government inspected, at a price up to 33 cents per pound, for shipment on May 10, to be confirmed by the following morning, and were interested in further offerings. After testing the market for price, Bauer accepted, and Stovicek sent a confirmation that evening. Plaintiff stresses that, although these and subsequent cables between plaintiff and defendant, which laid the basis for the additional quantities under the first and for all of the second contract, were predominantly in German, they used the English word “chicken”; it claims this was done because it understood “chicken” meant young chicken whereas the German word, “Huhn,” included both “Brathuhn” (broilers) and “Suppenhuhn” (stewing chicken), and that defendant, whose officers were thoroughly conversant with German, should have realized this. Whatever force

this argument might otherwise have is largely drained away by Bauer's testimony that he asked Stovicek what kind of chickens were wanted, received the answer "any kind of chickens," and then, in German, asked whether the cable meant "Huhn" and received an affirmative response. Plaintiff attacks this as contrary to what Bauer testified on his deposition in March, 1959, and also on the ground that Stovicek had no authority to interpret the meaning of the cable. The first contention would be persuasive if sustained by the record, since Bauer was free at the trial from the threat of contradiction by Stovicek as he was not at the time of the deposition; however, review of the deposition does not convince me of the claimed inconsistency. As to the second contention, it may well be that Stovicek lacked authority to commit plaintiff for prices or delivery dates other than those specified in the cable; but plaintiff cannot at the same time rely on its cable to Stovicek as its dictionary to the meaning of the contract and repudiate the interpretation given the dictionary by the man in whose hands it was put.

Plaintiff's next contention is that there was a definite trade usage that "chicken" meant "young chicken." Defendant showed that it was only beginning in the poultry trade in 1957, thereby bringing itself within the principle that "when one of the parties is not a member of the trade or other circle, his acceptance of the standard must be made to appear" by proving either that he had actual knowledge of the usage or that the usage is "so generally known in the community that his actual individual knowledge of it may be inferred." 9 JOHN HENRY WIGMORE, WIGMORE ON EVIDENCE § 2464 (3d ed. 1940). Here there was no proof of actual knowledge of the alleged usage; indeed, it is quite plain that defendant's belief was to the contrary. In order to meet the alternative requirement, the law of New York demands a showing that "the usage is of so long continuance, so well established, so notorious, so universal and so reasonable in itself, as that the presumption is violent that the parties contracted with reference to it, and made it a part of their agreement." *Walls v. Bailey*, 49 N.Y. 464, 472-473 (1872).

Plaintiff endeavored to establish such a usage by the testimony of three witnesses and certain other evidence. Strasser, resident buyer in New York for a large chain of Swiss cooperatives, testified that "on chicken I would definitely understand a broiler." However, the force of this testimony was considerably weakened by the fact that in his own transactions the witness, a careful businessman, protected himself by using "broiler" when that was what he wanted and "fowl" when he wished older birds. Indeed, there are some indications, dating back to a remark of Lord Mansfield, *Edie v. East India Co.*, 97 Eng. Rep. 797 (K.B. 1761), that no credit should be given "witnesses to usage, who could not adduce instances in verification." While Wigmore thinks this goes too far, a witness's consistent failure to rely on the alleged usage deprives his opinion testimony of much of its effect. Niesielowski, an officer of one of the companies that had furnished the stewing chicken to defendant, testified that "chicken" meant "the male species of the poultry industry. That could be a

broiler, a fryer or a roaster,” but not a stewing chicken; however, he also testified that upon receiving defendant’s inquiry for “chickens,” he asked whether the desire was for “fowl or frying chickens” and, in fact, supplied fowl, although taking the precaution of asking defendant, a day or two after plaintiff’s acceptance of the contracts in suit, to change its confirmation of its order from “chickens,” as defendant had originally prepared it, to “stewing chickens.” Dates, an employee of Urner-Barry Company, which publishes a daily market report on the poultry trade, gave it as his view that the trade meaning of “chicken” was “broilers and fryers.” In addition to this opinion testimony, plaintiff relied on the fact that the Urner-Barry service, the *Journal of Commerce*, and Weinberg Bros. & Co. of Chicago, a large supplier of poultry, published quotations in a manner which, in one way or another, distinguish between “chicken,” comprising broilers, fryers and certain other categories, and “fowl,” which, Bauer acknowledged, included stewing chickens. This material would be impressive if there were nothing to the contrary. However, there was, as will now be seen.

Defendant’s witness Weininger, who operates a chicken eviscerating plant in New Jersey, testified “Chicken is everything except a goose, a duck, and a turkey. Everything is a chicken, but then you have to say, you have to specify which category you want or that you are talking about.” Its witness Fox said that in the trade “chicken” would encompass all the various classifications. Sadina, who conducts a food inspection service, testified that he would consider any bird coming within the classes of “chicken” in the Department of Agriculture’s regulations to be a chicken. The specifications approved by the General Services Administration include fowl as well as broilers and fryers under the classification “chickens.” Statistics of the Institute of American Poultry Industries use the phrases “Young chickens” and “Mature chickens,” under the general heading “Total chickens,” and the Department of Agriculture’s daily and weekly price reports avoid use of the word “chicken” without specification.

Defendant advances several other points which it claims affirmatively support its construction. Primary among these is the regulation of the Department of Agriculture, 7 C.F.R. § 70.300-70.370 (1960), entitled, “Grading and Inspection of Poultry and Edible Products Thereof,” and in particular 70.301 which recited:

Chickens. The following are the various classes of chickens:

- (a) Broiler or fryer . . .
- (b) Roaster . . .
- (c) Capon . . .
- (d) Stag . . .
- (e) Hen or stewing chicken or fowl . . .
- (f) Cock or old rooster . . .

Defendant argues, as previously noted, that the contract incorporated these regulations by reference. Plaintiff answers that the contract provision related simply to grade and Government inspection and did not incorporate the Government definition of “chicken,” and also that the definition in the Regulations is ignored in the trade. However, the latter contention was contradicted by Weininger and Sadina; and there is force in defendant’s argument that the contract made the regulations a dictionary, particularly since the reference to Government grading was already in plaintiff’s initial cable to Stovicek.

Defendant makes a further argument based on the impossibility of its obtaining broilers and fryers at the 33 cents price offered by plaintiff for the 2½-3 lbs. birds. There is no substantial dispute that, in late April, 1957, the price for 2½-3 lbs. broilers was between 35 and 37 cents per pound, and that when defendant entered into the contracts, it was well aware of this and intended to fill them by supplying fowl in these weights. It claims that plaintiff must likewise have known the market since plaintiff had reserved shipping space on April 23, three days before plaintiff’s cable to Stovicek, or, at least, that Stovicek was chargeable with such knowledge. It is scarcely an answer to say, as plaintiff does in its brief, that the 33 cents price offered by the 2½-3 lbs. “chickens” was closer to the prevailing 35 cents price for broilers than to the 30 cents at which defendant procured fowl. Plaintiff must have expected defendant to make some profit—certainly it could not have expected defendant deliberately to incur a loss.

Finally, defendant relies on conduct by the plaintiff after the first shipment had been received. On May 28 plaintiff sent two cables complaining that the larger birds in the first shipment constituted “fowl.” Defendant answered with a cable refusing to recognize plaintiff’s objection and announcing “We have today ready for shipment 50,000 lbs. chicken 2½-3 lbs. 25,000 lbs. broilers 1½-2 lbs.,” these being the goods procured for shipment under the second contract, and asked immediate answer “whether we are to ship this merchandise to you and whether you will accept the merchandise.” After several other cable exchanges, plaintiff replied on May 29 “Confirm again that merchandise is to be shipped since resold by us if not enough pursuant to contract chickens are shipped the missing quantity is to be shipped within ten days stop we resold to our customers pursuant to your contract chickens grade A you have to deliver us said merchandise we again state that we shall make you fully responsible for all resulting costs.” Defendant argues that if plaintiff was sincere in thinking it was entitled to young chickens, plaintiff would not have allowed the shipment under the second contract to go forward, since the distinction between broilers and chickens drawn in defendant’s cablegram must have made it clear that the larger birds would not be broilers. However, plaintiff answers that the cables show plaintiff was insisting on delivery of young chickens and that defendant shipped old ones at its peril. Defendant’s point would be highly relevant on another disputed issue—whether if liability were established, the measure of damages should be the

difference in market value of broilers and stewing chicken in New York or the larger difference in Europe, but I cannot give it weight on the issue of interpretation. Defendant points out also that plaintiff proceeded to deliver some of the larger birds in Europe, describing them as “poulets”; defendant argues that it was only when plaintiff’s customers complained about this that plaintiff developed the idea that “chicken” meant “young chicken.” There is little force in this in view of plaintiff’s immediate and consistent protests.

When all the evidence is reviewed, it is clear that defendant believed it could comply with the contracts by delivering stewing chicken in the 2½-3 lbs. size. Defendant’s subjective intent would not be significant if this did not coincide with an objective meaning of “chicken.” Here it did coincide with one of the dictionary meanings, with the definition in the Department of Agriculture Regulations to which the contract made at least oblique reference, with at least some usage in the trade, with the realities of the market, and with what plaintiff’s spokesman had said. Plaintiff asserts it to be equally plain that plaintiff’s own subjective intent was to obtain broilers and fryers; the only evidence against this is the material as to market prices and this may not have been sufficiently brought home. In any event it is unnecessary to determine that issue. For plaintiff has the burden of showing that “chicken” was used in the narrower rather than in the broader sense, and this it has not sustained.

This opinion constitutes the Court’s findings of fact and conclusions of law. Judgment shall be entered dismissing the complaint with costs.

Review Question 6. *Frigaliment* (usually pronounced frih-gah-le-MAHN) is a very popular case in contracts classes because it is an excellent example of a court carefully interpreting an ambiguous term. More than most cases, this one is an opinion you should carefully go through and outline it. What evidence does the court consider? How does it go about evaluating the evidence? Why ultimately does the seller win? If you cannot answer those questions, you have not read the case carefully enough.

Review Question 7. Judge Friendly says that “Defendant’s subjective intent would not be significant if this did not coincide with an objective meaning of ‘chicken.’” What does this statement suggest to you about how *subjective* and *objective* understandings of contract language relate to each other?

RANDOM HOUSE, INC. v. ROSETTA BOOKS LLC

United States District Court for the Southern District of New York
150 F. Supp. 2d 613 (S.D.N.Y. 2001)

SIDNEY H. STEIN, U.S.D.J.

In the year 2000 and the beginning of 2001, Rosetta Books contracted with several authors to publish certain of their works—including *The Confessions of Nat Turner* and *Sophie's Choice* by William Styron; *Slaughterhouse-Five*, *Breakfast of Champions*, *The Sirens of Titan*, *Cat's Cradle*, and *Player Piano* by Kurt Vonnegut; and *Promised Land* by Robert B. Parker—in digital format over the internet. On February 26, 2001 Rosetta Books launched its ebook business, offering those titles and others for sale in digital format. The next day, Random House filed this complaint accusing Rosetta Books of committing copyright infringement and tortiously interfering with the contracts Random House had with Messrs. Parker, Styron and Vonnegut by selling its ebooks. It simultaneously moved for a preliminary injunction prohibiting Rosetta from infringing plaintiff's copyrights.

Ebooks are “digital book[s] that you can read on a computer screen or an electronic device.” Although the text of the ebook is exactly the same as the text of the original work, the ebook contains various features that take advantage of its digital format.

[Random House had entered into contracts with Styron in 1961 and 1977. with Vonnegut in 1967 and 1970, and with Parker in 1982. Each contract gave Random House the rights to publish the books, along with various other rights (film, Braille, television, condensed book, foreign translations, overseas sales, etc.) that varied somewhat from contract to contract. Each contract, though, specified—and this is the key language in the case—that Random House had the exclusive right, within the particular territory, to “print, publish and sell the work *in book form*” (emphasis added). Random House claimed that an ebook involved publishing “in book form.” Rosetta claimed it was not “in book form.”

In New York, a written contract is to be interpreted so as to give effect to the intention of the parties as expressed in the contract's language. The court must consider the entire contract and reconcile all parts, if possible, to avoid an inconsistency.

Determining whether a contract provision is ambiguous is a question of law to be decided by the court. *See W.W.W. Associates, Inc. v. Giancontieri*, 566 N.E.2d 639, 642 (N.Y. 1990). Pursuant to New York law, “contract language is ambiguous if it is capable of more than one meaning when viewed objectively by a reasonably intelligent person who has examined the context of the entire integrated agreement and who is cognizant of the customs, practices, usages and terminology as generally

understood in the particular trade or business.” *Sayers v. Rochester Telephone Corp. Supplemental Management Pension Plan*, 7 F.3d 1091, 1095 (2d Cir. N.Y. 1993).

These principles are in accord with the approach the U.S. Court of Appeals for the Second Circuit uses in analyzing contractual language in disputes, such as this one, “about whether licensees may exploit licensed works through new marketing channels made possible by technologies developed after the licensing contract—often called ‘new use’ problems.” *Boosey & Hawkes Music Publishers, Ltd v. Walt Disney Co.*, 145 F.3d 481, 486 (2d Cir. 1998). The two leading cases in this Circuit on how to determine whether “new uses” come within prior grants of rights are *Boosey and Bartsch v. Metro-Goldwyn-Mayer, Inc.*, 391 F.2d 150 (2d Cir. 1968), decided three decades apart.

In *Bartsch*, the author of the play “Maytime” granted Harry Bartsch in 1930 “the motion picture rights throughout the world,” including the right to “copyright, vend, license and exhibit such motion picture photoplays throughout the world; together with the further sole and exclusive rights by mechanical and/or electrical means to record, reproduce and transmit sound, including spoken words.” He in turn assigned those rights to Warner Bros. Pictures, which transferred them to MGM. In 1958 MGM licensed its motion picture “Maytime” for viewing on television. Bartsch sued, claiming the right to transmit the play over television had not been given to MGM.

Judge Henry Friendly, for the Second Circuit,⁵ wrote in 1968 that “any effort to reconstruct what the parties actually intended nearly forty years ago is doomed to failure.” He added that the words of the grant by Bartsch “were well designed to give the assignee [i.e., MGM] the broadest rights with respect to its copyrighted property.” The words of the grant were broad enough to cover the new use—*i.e.* viewing on television—and Judge Friendly interpreted them to do so. This interpretation, he wrote, permitted the licensee to “properly pursue any uses which may reasonably be said to fall within the medium as described in the license.” That interpretation also avoided the risk “that a deadlock between the grantor and the grantee might prevent the work’s being shown over the new medium at all.”

In *Boosey*, the plaintiff was the assignee of Igor Stravinsky’s copyrights in the musical composition, “The Rite of Spring.” In 1939, Stravinsky had licensed Disney’s use of “The Rite of Spring” in the motion picture “Fantasia.” Fifty-two years later, in 1991, Disney released “Fantasia” in video format and Boosey brought an action seeking, among other relief, a declaration that the grant of rights did not include the right to use the Stravinsky work in video format. In *Boosey*, just as in *Bartsch*, the language of the grant was broad, enabling the licensee “to record in any manner,

⁵ [Yes, the same judge who decided *Frigaliment*, this time sitting on the Second Circuit Court of Appeals rather than handling a trial. – Eds.]

medium or form, and to license the performance of, the musical composition [for use] in a motion picture.”

At the Second Circuit, a unanimous panel focused on “neutral principles of contract interpretation rather than solicitude for either party.” *Id.* at 487. “What governs,” Judge Pierre Leval wrote, “is the language of the contract. If the contract is more reasonably read to convey one meaning, the party benefitted by that reading should be able to rely on it; the party seeking exception or deviation from the meaning reasonably conveyed by the words of the contract should bear the burden of negotiating for language that would express the limitation or deviation. This principle favors neither licensors nor licensees. It follows simply from the words of the contract.”⁶

Relying on “the language of the license contract and basic principles of interpretation,” this Court finds that the most reasonable interpretation of the grant in the contracts at issue to “print, publish and sell the work in book form” does not include the right to publish the work as an ebook. At the outset, the phrase itself distinguishes between the pure content—*i.e.* “the work”—and the format of display—“in book form.” The Random House Webster’s Unabridged Dictionary defines a “book” as “a written or printed work of fiction or nonfiction, usually on sheets of paper fastened or bound together within covers” and defines “form” as “external appearance of a clearly defined area, as distinguished from color or material; the shape of a thing or person.” Manifestly, paragraph #1 of each contract—entitled either “grant of rights” or “exclusive publication right”—conveys certain rights from the author to the publisher. In that paragraph, separate grant language is used to convey the rights to publish book club editions, reprint editions, abridged forms, and editions in Braille. This language would not be necessary if the phrase “in book form” encompassed all types of books. That paragraph specifies exactly which rights were being granted by the author to the publisher. Indeed, many of the rights set forth in the publisher’s form contracts were in fact not granted to the publisher, but rather were reserved by the authors to themselves. For example, each of the authors specifically reserved certain rights for themselves by striking out phrases, sentences, and paragraphs of the publisher’s form contract. This evidences an intent by these authors not to grant the publisher the broadest rights in their works.

⁶ [The *Random House* opinion is not entirely clear on what then happened in *Boosey*. Ultimately, the *Boosey* court held that “[n]either the plain terms of the 1939 Agreement nor the sparse and contradictory extrinsic evidence require the conclusion that Disney’s license is limited to theatrical performance of the composition.” *Boosey & Hawkes Music Publishers, Ltd. v. Walt Disney Co.*, 145 F.3d 481, 491 (2d Cir. 1998). Accordingly, the district court’s summary judgment against Disney on interpretation of the licensing agreement was “inappropriate,” and the case was remanded al court for further proceedings. *Id.* – Eds.]

Random House contends that the phrase “in book form” means to faithfully reproduce the author’s text in its complete form as a reading experience and that, since ebooks concededly contain the complete text of the work, Rosetta cannot also possess those rights. While Random House’s definition distinguishes “book form” from other formats that require separate contractual language—such as audio books and serialization rights—it does not distinguish other formats specifically mentioned in paragraph #1 of the contracts, such as book club editions and reprint editions. Because the Court must, if possible, give effect to all contractual language in order to “safeguard against adopting an interpretation that would render any individual provision superfluous,” *Sayers*, 7 F.3d at 1095, Random House’s definition cannot be adopted.

[Some, but not all, of the contracts contained an additional clause that provided: “The Author agrees that during the term of this agreement he will not, without the written permission of the Publisher, publish or permit to be published any material in book or pamphlet form, based on the material in the work, or which is reasonably likely to injure its sale.”]

Random House cites the non-compete clauses as evidence that the authors granted it broad, exclusive rights in their work. Random House reasons that because the authors could not permit any material that would injure the sale of the work to be published without Random House’s consent, the authors must have granted the right to publish ebooks to Random House. This reasoning turns the analysis on its head. First, the grant of rights follows from the grant language alone. Second, non-compete clauses must be limited in scope in order to be enforceable in New York. Third, even if the authors did violate this provision of their Random House agreements by contracting with Rosetta Books—a point on which this Court does not opine—the remedy is a breach of contract action against the authors, not a copyright infringement action against Rosetta Books.

The photocopy clause—giving Random House the right to “Xerox and other forms of copying, either now in use or hereafter developed” —similarly does not bolster Random House’s position. Although the clause does appear in the grant language paragraph, taken in context, it clearly refers only to new developments in xerography and other forms of photocopying. Stretching it to include new forms of publishing, such as ebooks, would make the rest of the contract superfluous because there would be no reason for authors to reserve rights to forms of publishing “now in use.” This interpretation also comports with the publishing industry’s trade usage of the phrase.

Not only does the language of the contract itself lead almost ineluctably to the conclusion that Random House does not own the right to publish the works as ebooks, but also a reasonable person “cognizant of the customs, practices, usages and terminology as generally understood in the particular trade or business,” *Sayers*, 7 F.3d at 1095, would conclude that the grant language does not include ebooks. “To

print, publish and sell the work in book form” is understood in the publishing industry to be a “limited” grant. See *Field v. True Comics*, 89 F. Supp. 611, 613-14 (S.D.N.Y. 1950);⁷ see also MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT, § 10.14[C] (2001) (citing *Field*).

Boosey and *Bartsch*, which apply to new uses within the same medium, do not control this case. See, e.g., *Raine v. CBS, Inc.*, 25 F. Supp. 2d 434, 445 (S.D.N.Y. 1998) (finding that the right to “television broadcasts” did not include broadcasts on cable television or videocassettes); *General Mills, Inc. v. Filmtel Int’l Corp.*, 599 N.Y.S.2d 820, 821-22 (Sup. Ct. App. Div. 1993) (same); *Tele-Pac, Inc. v. Grainger*, 570 N.Y.S.2d 521 (Sup. Ct. App. Div. 1991) (distinguishing Second Circuit “new use” doctrine by holding that right to “broadcast[] by television or any other similar device now known or hereafter to be made known” was so dissimilar from display on videocassette and videodisc “as to preclude consideration of video rights as even falling within the ‘ambiguous penumbra’ of the terms used in the agreement”).

Employing the most important tool in the armamentarium of contract interpretation—the language of the contract itself—this Court has concluded that Random House is not the beneficial owner of the right to publish the eight works at issue as ebooks.

Review Question 8. Why exactly, according to the *Random House* court, is an “ebook” *not* something “in book form,” while “motion picture rights” *do* include a television broadcast? Are these results self-evident under the analytical framework articulated by the Second Circuit, or could you argue for the cases to come out differently while using the same rule? If asked to do so, would you be able to apply the *Random House* test to a media format that did not exist at the time of an earlier contract?

⁷ [The *Field* case held that publishing a comic book based on Joe DiMaggio’s autobiography was not a publication “in book form.” – Eds.]

Problems

Problem 18.1

Pantera's is a chain of "café-style" restaurants. It enters into a contract with Shopping Center to put a Pantera café in the center. As part of the negotiations, Pantera's insists that it wants to limit competition within the center. The Center has other tenants, however, who also serve food. After negotiation, the parties agree to the following language:

Center agrees not to enter into a lease, occupancy agreement or license affecting space in the Shopping Center or consent to an amendment to an existing lease permitting use . . . for a bakery or restaurant reasonably expected to have annual sales of sandwiches greater than ten percent (10%) of its total sales or primarily for the sale of high quality coffees or teas, such as, but not limited to, Starbucks, Tea-Luxe, Pete's Coffee and Tea, and Finagle a Bagle. The foregoing shall not apply to (i) a business serving near-Eastern food and related products, (ii) restaurants primarily for sit-down table service, (iii) a KFC restaurant, and (iv) a Papa Gino's restaurant (provided the same continues to operate with substantially the same categories of menu items as now apply to its stores and franchisees generally).

The parties sign the contract, the Pantera café opens, and it becomes successful. Subsequently, Shopping Center is approached by Adoba, a national chain of "Mexican Grills" that serve various items in a café-style setting that does not involve sit-down table service. On learning of these discussions, Pantera's protests, claiming that burritos, tacos, and quesadillas are "sandwiches" and that they account for more than 10 percent of Adoba's sales. Pantera's sues, asking for an injunction against its claimed violation of the lease. What result and why?

Problem 18.2

Homeowner lives in a coastal community that is sometimes subject to hurricanes. She has a "homeowner's insurance" policy on her home, issued by Arcturus Life & Casualty Co., an insurer licensed in Homeowner's state. The Arcturus policy, a standard form used by many different insurers, provides that it will cover "direct physical loss to structures on the property" from any cause, except for "excluded perils." Among the list of "excluded perils" is:

Damage from . . . flood, surface water, waves, tidal water, overflow of a body of water, or spray from any of these, whether or not driven by wind.

When Hurricane Rubin strikes the local community, the storm causes a breach in the levee system that protects the community. A storm surge inundates the

neighborhood and Homeowner's house is destroyed. Homeowner argues that the levee was negligently designed and maintained, and that her loss was caused by this negligence, not by the storm. Arcturus argues that the levees were wrecked by "tidal water" and "wind" and that the house was inundated by water, which by definition means "flood." Is the loss covered by Arcturus's policy? Why or why not?

Problem 18.3

Giada has negotiated a restaurant lease with Lessor to open her new restaurant. The restaurant has both gas and electric lines running into it, and at the time the building is leased it has a non-functional and non-repairable gas cooking range. The lease provides:

The Lessor shall furnish free to and for the use of the Lessee in connection with the use and occupancy of the premises, herein demised, electric power, electric light, heat, electric light bulbs but [Giada] shall pay for all gas or fuel used in the preparation of food.

Giada installs a new electric range and various microwave and electric convection ovens. When Lessor gets the electric bill, it refuses to pay for the electricity used in cooking because it is "fuel used in the preparation of food."

What are the arguments both parties could raise on interpreting that phrase? Is either side's position stronger than the other's?

Problem 18.4

Delta Barge Co. is a company in the business of transporting bulk cargoes (grain, coal, stone, bulk chemicals, scrap metal, etc.) on the Mississippi River through its fleet of barges and tugboats. Delta has a policy of insurance with Inland Marine Insurance that covers its barges and cargoes. The policy specifically excludes coverage for loss caused by "fire or explosion," but covers all losses resulting from "perils of the river." When one its barges, carrying tanks of kerosene, accidentally rams a sunken obstruction, it begins to take on water. Worse, the accident ruptures the kerosene tanks and the liquid spills out, catching fire. Ultimately one of the kerosene tanks explodes, destroying the barge and all its cargo. Delta files a claim, which Inland denies. Is the loss covered by the Inland policy?

Unit 19: Conditions

TERMS AND INTERPRETATION

Part Three

FOCUS OF THIS UNIT

Conditional Obligations. Parties to contracts make promises that they will do things. But sometimes those promises are supposed to be performed only if something happens to trigger a duty. Suppose, for example, you buy a single-premium life insurance policy, which costs you \$100,000 but will pay your estate \$2 million whenever you die. You, the insured, have no obligation to die. But the insurance company has no obligation to pay money to your estate until you do. The contract is in force, and you have fully performed, but the insurer's duty is *conditional* on the occurrence of your death. If for some reason you manage to live forever, the contract will last forever but you will never get the money. The best way to think of conditions is as *triggers* to obligations that occur *within* contracts.

Two broad categories of conditions exist: *express* and *implied*. In both, the party refusing to perform claims its duty was never triggered because the other party did not satisfy the condition. The party seeking performance may claim variously that (1) properly interpreted, the claimed condition is not a condition at all; (2) that there is a condition, but it was in fact complied with; (3) even if the condition was not strictly complied with, there is a good excuse for not doing so; or (4) some or all of the above.

Spotting Express Conditions. You can often recognize *express* conditions by phrases like "if . . . then," "provided that," "upon the occurrence of," and the like. The established hornbook law, repeated by many courts, is that express conditions like these must be complied with strictly. But, as you will also see in this unit, there are ways that a party can get by with something less than strict compliance.

Unseen Implied Conditions. *Implied* or *constructive* conditions are those read into the contract by courts, in much the same way as other implied terms. Conditions are usually implied when it appears that the parties intended that performance occur in a particular sequence. The leading English case is *Kingston v. Preston*, 99 Eng. Rep. 437 (K.B. 1773), which involved the sale of a business. The seller agreed to convey the business, and the buyer agreed to put up a bond to ensure payment for the business. The contract was silent, however, as to which was supposed to happen first. The King's Bench held that, by the nature of things, the seller should not have

to convey the business until after the bond had been posted—to do it the other way around would have been absurd, as the whole point of the bond was to protect the seller.

Courts tend to be rather cautious about implying conditions, but when it seems clear that the parties must have intended that one performance be contingent on another, they will do so.

Sections 224 through 230 of the Restatement (Second) of Contracts attempt to distill the common—and common law—rules regarding conditions. Reviewing those sections could provide you some helpful context. As with all sections of the Restatement, we caution you be careful not to take these as stating exclusive or universal rules on point. As with all areas of judge-made common law, only the case authority from that jurisdiction is controlling. Thus, you should always read cases carefully to determine any state’s actual version of a legal rule.

Cases and Materials

NORTH HOUSTON INTERNATIONAL, L.L.C., v. PW REAL ESTATE INVESTMENTS, INC.

Court of Appeals of Texas, Fourteenth District—Houston
2003 Tex. App. LEXIS 9185

LESLIE BROCK YATES, J.:

[North Houston International owned an office building, and sought a commercial mortgage on the property from Paine Webber Real Estate Investments (“PW”). PW and North Houston subsequently entered into a letter agreement for a loan commitment, and North Houston paid PW \$45,000 to cover its application fee and expenses in the process. The Commitment Letter expressly required that North Houston obtain estoppel certificates¹ from all tenants, including the building’s anchor

¹ [When lender is refinancing the mortgage on a building that is leased to another, the lender wants to be sure there are no hidden problems with the lease that might allow the tenant to pay less or escape the lease entirely—which might endanger the lender’s chance of getting repaid. The lender wants to be aware of any disputes between owner and tenant, of any alleged modifications to the lease, of the amount of prepaid rent, and so forth. Thus, commercial leases usually provide that tenants, on proper request from the landlord, must execute an “estoppel certificate” covering such issues. These certificates state that the lender is entitled to rely on the tenant’s representations, and that the tenant thus would be estopped from raising these arguments later.—Eds.]

tenant, the U.S. Customs Service. Unfortunately, when North Houston agreed to provide these certificates it was unaware of 48 C.F.R. § 552.270-24, which prohibits federal agencies and employees from signing estoppel certificates. North Houston instead provided uncertified letters from the Custom Services confirming that the leases were in effect. PW refused to close and fund the loan, and refused to return North Houston's money on the basis that North Houston did not provide the estoppel certificate.]

The parties are in agreement that the choice-of-law provision in the Commitment Letter dictates that New York substantive law applies to North Houston's claims based on construction and enforcement of the contract.

This lawsuit revolves around express conditions precedent² in the parties' Commitment Letter. As the movant for summary judgment, PW had the burden to produce conclusive summary judgment evidence that proved North Houston failed to comply with a condition precedent in the Commitment Letter, thereby relieving PW of the obligation to fund the loan. Where contractual language is plain on its face, it should be so construed as a matter of law in the summary judgment context.

Two conditions precedent in the Commitment Letter are at issue. The first one, under the heading of "Closing Requirements," reads, in pertinent part, as follows:

PaineWebber shall not be obligated to close or fund the Mortgage Loan unless and until PaineWebber has received the following, at the sole cost and expense of Borrower: . . .

H. At PaineWebber's request, Borrower shall deliver, prior to closing and from time to time thereafter, estoppel certificates in form and substance satisfactory to PaineWebber, from all tenants under then existing commercial leases covering any portion of the property which PaineWebber in its discretion designates.

The first addendum to the Commitment Letter adds, as a condition precedent, the following: "Subject to the receipt and review of an estoppel showing U.S. Customs paying the full new rental amount of \$461,608 annually on 31,835 square feet."

Pursuant to the Commitment Letter's express terms, PW and North Houston, both sophisticated parties with experience in commercial real estate transactions, agreed that North Houston's performance of these conditions was a prerequisite to the funding of the loan. Giving these conditions precedent their plain meaning (neither party argues ambiguity), the loan funding was contingent upon North Houston

² [By the court] "A condition precedent is 'an act or event, other than a lapse of time, which, unless the condition is excused, must occur before a duty to perform a promise in the agreement arises.'" *Oppenheimer & Co., Inc. v. Oppenheim, Appel, Dixon & Co.*, 660 N.E.2d 415, 418 (N.Y. 1995); see also *Lindenbaum v. Royco Prop. Corp.*, 567 N.Y.S.2d 218, 220 (Sup. Ct. App. Div. 1991). "Express conditions are those agreed to and imposed by the parties themselves. [Generally, such] conditions must be literally performed." *Oppenheimer*, 660 N.E.2d at 418. The parties do not dispute that the conditions in the Commitment Letter were express conditions.

delivering tenant estoppel certificates in form and substance satisfactory to PW, and, in particular, showing the U.S. Customs Service paying the full new rental amount and leasing the specified square footage. *See Facilities Dev. Corp. v. Nautilus Constr. Corp.*, 550 N.Y.S.2d 127, 128 (App. Div. 1989) (noting that a condition precedent exists when the contract shows an intent by the parties to have one party's performance precede any obligation by the other party). Without the required estoppel certificate from the U.S. Customs Service, PW had no obligation to close or fund the mortgage loan.

Here, Scott Leitman, a PW employee, testified in his affidavit that, to the best of his knowledge, North Houston did not provide an estoppel certificate showing the U.S. Customs Service in occupancy paying the full new rental amount of \$461,608 annually on 31,835 square feet. North Houston argues that the U.S. Customs Service could not have supplied that information in its statement of lease due to governmental regulations.

In its first issue, North Houston contends the two letters from the U.S. Customs Service addressed to it and forwarded to PW, coupled with the U.S. Customs leases that PW had received and approved, satisfy the conditions precedent or at least raise a fact question regarding North Houston's compliance. We disagree. The express terms of the Commitment Letter required North Houston to produce to PW an estoppel certificate from the U.S. Customs Service with the full amount of rent and the total amount of leased square footage. Because the terms are express, PW is not required to waive them or accept other forms of documentation to satisfy them. *See, e.g., Preferred Mortgage Brokers, Inc. v. Byfield*, 723 N.Y.S.2d 230, 231 (Sup. Ct. App. Div. 2001) (holding that when an express condition precedent is not met, the other party is not obligated to perform).

Review Question 1. Shouldn't North Houston have been excused from performing the condition precedent of obtaining an estoppel certificate from its largest tenant based on the legal impossibility of fulfilling the condition? If not, then what lessons does this case hold for future lawyers (like you) who may one day be drafting documents in a real estate transaction?

Review Question 2. Neither of the parties in *North Houston International* disputed the fact that the estoppel certificates were express conditions. Read the definition in Restatement (Second) of Contracts § 224 and see if you can explain why no one argued the point.

Review Question 3. In the famous case of *Clark v. West* that follows, the parties—unlike those in *North Houston International*—do not agree whether the promises in question were conditional. As you read *Clark*, can you understand (and

explain) the arguments that the law professor's abstention from alcohol was (or was not) a condition of his payment?

CLARK v. WEST

Court of Appeals of New York
193 N.Y. 349, 86 N.E. 1 (1908)

On February 12th, 1900, the plaintiff [Clark] and defendant [West] entered into a written contract under which the former was to write and prepare for publication for the latter a series of law books the compensation for which was provided in the contract.³ After the plaintiff had completed a three-volume work known as *Clark & Marshall on Corporations*, the parties disagreed. The plaintiff claimed that the defendant had broken the contract. The defendant demurred to the complaint on the ground that it did not state facts sufficient to constitute a cause of action. The Special Term overruled the demurrer, but upon appeal to the Appellate Division, that decision was reversed and the demurrer sustained.

Those portions of the contract which are germane to the present stage of the controversy are as follows: The plaintiff agreed to write a series of books relating to specified legal subjects; the manuscript furnished by him was to be satisfactory to the defendant; the plaintiff was not to write or edit anything that would interfere with the sale of books to be written by him under the contract and he was not to write any other books unless requested so to do by the defendant, in which latter event he was to be paid \$3,000 a year. The contract contained a clause which provided that

The first party (the plaintiff) agrees to totally abstain from the use of intoxicating liquors during the continuance of this contract, and that the payment to him in accordance with the terms of this contract of any money in excess of \$2 per page

³ [William Lawrence Clark, Jr., was one of the most successful legal treatise writers of all time. He started publishing with John Briggs West, the 8th-grade-educated former grocery clerk and traveling salesman who—while still living in his parents' house—founded West Publishing Co. West revolutionized legal practice, creating the North Western Reporter (and the subsequent National Reporter System) in 1877 and the American Digest System (with its revolutionary key numbers) ten years later. West expanded into legal treatises, and Clark was hired to write West's first "Hornbooks" on Criminal Law and Criminal Procedure, which at \$3.75 each—then about the average day's wage for a male teacher—sold like hotcakes to American law students. In 1894, West published *Clark on Contracts*, which also became very popular, and also *Clark on Corporations*. In 1899 Clark was hired as a law professor at Washington & Lee University, but after engaging in what seems to have been a course of unusually public drunkenness, he was fired after only a month or two. (His antics at W&L were apparently notable enough that his firing was noted in newspapers as far away as Baltimore and New York.) Meanwhile, John West had abruptly left West Publishing in 1899 and had launched a new venture, Keefe-Davidson Law Book Co. West was looking for authors, and Clark was looking for income. West wanted Clark to come over to Keefe-Davidson to write a new edition of an earlier Keefe-Davidson book, *Marshall on Corporations*.—Eds.]

is dependent on the faithful performance of this as well as the other conditions of this contract.

In a later paragraph it further recited that,

In consideration of the above promises of the first party (the plaintiff), the second party (the defendant) agrees to pay to the first party \$2 per page, on each book prepared by the first party under this contract and accepted by the second party, and if said first party abstains from the use of intoxicating liquor and otherwise fulfills his agreements as hereinbefore set forth, he shall be paid an additional \$4 per page in manner hereinbefore stated.

[The contract further provided for progress payments at the \$2 level upon delivery of every 125 pages, not to exceed \$250 a month. If the final manuscript was acceptable to West and were published, Clark would be paid 1/6 of the net receipts of the books until he reached the level of \$6 a page, at which point he would get no further royalties.]

The plaintiff in his complaint alleges completion of the work on corporations and publication thereof by the defendant; the sale of many copies thereof from which the defendant received large net receipts; the number of pages it contained (3,469), for which he had been paid at the rate of \$2 per page, amounting to \$6,938; and that defendant has refused to pay him any sum over and above that amount, or any sum in excess of \$2 per page. Full performance of the agreement on plaintiff's part is alleged, except that he "did not totally abstain from the use of intoxicating liquor during the continuance of said contract, but such use by the plaintiff was not excessive and did not prevent or interfere with the due and full performance by the plaintiff of all the other stipulations in said contract." The complaint further alleges a waiver on the part of the defendant of the plaintiff's stipulation to totally abstain from the use of intoxicating liquors,

WERNER, J.

The contract before us, stripped of all superfluous verbiage, binds the plaintiff to total abstention from the use of intoxicating liquors during the continuance of the work which he was employed to do. The stipulations relating to the plaintiff's compensation provide that if he does not observe this condition he is to be paid at the rate of \$2 per page, and if he does comply therewith he is to receive \$6 per page. The plaintiff has written one book under the contract known as "Clark & Marshall on Corporations," which has been accepted, published and copies sold in large numbers by the defendant. The plaintiff admits that while he was at work on this book he did not entirely abstain from the use of intoxicating liquors. He has been paid only \$2 per page for the work he has done. He claims that, despite his breach of this condition, he is entitled to the full compensation of \$6 per page because the defendant, with full knowledge of plaintiff's non-observance of this stipulation as to total abstinence, has waived the breach thereof and cannot now insist upon strict performance in this

regard. This plea of waiver presents the underlying question which determines the answers to the questions certified.

Briefly stated, the defendant's position is that the stipulation as to plaintiff's total abstinence is the consideration for the payment of the difference between \$2 and \$6 per page and therefore could not be waived except by a new agreement to that effect based upon a good consideration; that the so-called waiver alleged by the plaintiff is not a waiver but a modification of the contract in respect of its consideration. The plaintiff on the other hand argues that the stipulation for his total abstinence was merely a condition precedent intended to work a forfeiture of the additional compensation in case of a breach and that it could be waived without any formal agreement to that effect based upon a new consideration.

The compensation for the work specified in the contract was to be \$6 per page, unless the plaintiff failed to totally abstain from the use of intoxicating liquors during the continuance of the contract, in which event he was to receive only \$2 per page. That is the obvious import of the contract construed in the light of the purpose for which it was made, and in accordance with the ordinary meaning of plain language. It is not a contract to write books in order that the plaintiff shall keep sober, but a contract containing a stipulation that he shall keep sober so that he may write satisfactory books. When we view the contract from this standpoint it will readily be perceived that the particular stipulation is not the consideration for the contract, but simply one of its conditions which fits in with those relating to time and method of delivery of manuscript, revision of proof, citation of cases, assignment of copyrights, keeping track of new cases and citations for new editions, and other details which might be waived by the defendant, if he saw fit to do so. This is made clear, it seems to us, by the provision that, "In consideration of the above promises," the defendant agrees to pay the plaintiff \$2 per page on each book prepared by him, and if he "abstains from the use of intoxicating liquor and otherwise fulfills his agreements as hereinbefore set forth, he shall be paid an additional \$4 per page in manner hereinbefore stated." The compensation of \$2 per page, not to exceed \$250 per month, was an advance or partial payment of the whole price of \$6 per page, and the payment of the two-thirds which was to be withheld pending the performance of the contract, was simply made contingent upon the plaintiff's total abstention from the use of intoxicants during the life of the contract. It is obvious that the parties thought that the plaintiff's normal work was worth \$6 per page. That was the sum to be paid for the work done by the plaintiff and not for total abstinence. If the plaintiff did not keep to the condition as to total abstinence, he was to lose part of that sum. Precisely the same situation would have arisen if the plaintiff had disregarded any of the other essential conditions of the contract. The fact that the particular stipulation was emphasized did not change its character. It was still a condition which the defendant could have insisted upon, as he has apparently done in regard to some others, and one which he could waive just as he might have waived those relating to the amount of the advance payments, or the number of pages to be written each month. This, we

think, is the fair interpretation of the contract, and it follows that the stipulation as to the plaintiff's total abstinence was nothing more nor less than a condition precedent. If that conclusion is well founded there can be no escape from the corollary that this condition could be waived; and if it was waived the defendant is clearly not in a position to insist upon the forfeiture which his waiver was intended to annihilate. The forfeiture must stand or fall with the condition. If the latter was waived, the former is no longer a part of the contract. Defendant still has the right to counterclaim for any damages which he may have sustained in consequence of the plaintiff's breach, but he cannot insist upon strict performance.

This whole discussion is predicated of course upon the theory of an express waiver. We assume that no waiver could be implied from the defendant's mere acceptance of the books and his payment of the sum of \$2 per page without objection. It was the defendant's duty to pay that amount in any event after acceptance of the work. The plaintiff must stand upon his allegation of an express waiver and if he fails to establish that he cannot maintain his action.

The theory upon which the defendant's attitude seems to be based is that even if he has represented to the plaintiff that he would not insist upon the condition that the latter should observe total abstinence from intoxicants, he can still refuse to pay the full contract price for his work. The inequity of this position becomes apparent when we consider that this contract was to run for a period of years, during a large portion of which the plaintiff was to be entitled only to the advance payment of \$2 per page, the balance being contingent, among other things, upon publication of the books and returns from sales. Upon this theory the defendant might have waived the condition while the first book was in process of production, and yet when the whole work was completed, he would still be in a position to insist upon the forfeiture because there had not been strict performance. Such a situation is possible in a case where the subject of the waiver is the very consideration of a contract but not where the waiver relates to something that can be waived. In the case at bar, as we have seen, the waiver is not of the consideration or subject-matter, but of an incident to the method of performance. The consideration remains the same. The defendant has had the work he bargained for, and it is alleged that he has waived one of the conditions as to the manner in which it was to have been done. He might have insisted upon literal performance and then he could have stood upon the letter of his contract. If, however, he has waived that incidental condition, he has created a situation to which the doctrine of waiver very precisely applies.

A waiver has been defined to be the intentional relinquishment of a known right. It is voluntary and implies an election to dispense with something of value, or forego some advantage which the party waiving it might at its option have demanded or insisted upon. 2 HENRY M. HERMAN, COMMENTARIES ON THE LAW OF ON ESTOPPEL & RES ADJUDICATA, 954 (1886); *Cowenhoven v. Ball*, 23 N.E. 470 (N.Y. 1890), and this

definition is supported by many cases in this and other states. *See, e.g. Draper v. Oswego County Fire Relief Assn.*, 82 N.E. 755 (N.Y. 1907),

It remains to be determined whether the plaintiff has alleged facts which, if proven, will be sufficient to establish his claim of an express waiver by the defendant of the plaintiff's breach of the condition to observe total abstinence. In the 12th paragraph of the complaint, the plaintiff alleges facts and circumstances which we think, if established, would prove defendant's waiver of plaintiff's performance of that contract stipulation. These facts and circumstances are that long before the plaintiff had completed the manuscript of the first book undertaken under the contract, the defendant had full knowledge of the plaintiff's non-observance of that stipulation, and that with such knowledge he not only accepted the completed manuscript without objection, but repeatedly avowed and represented to the plaintiff that he was entitled to and would receive said royalty payments (*i.e.*, the additional \$4 per page), and plaintiff believed and relied upon such representations and at all times during the writing of said treatise on corporations, and after as well as before publication thereof as aforesaid, it was mutually understood, agreed and intended by the parties hereto that notwithstanding plaintiff's said use of intoxicating liquors, he was nevertheless entitled to receive and would receive said royalty as the same accrued under said contract.

The demurrer not only admits the truth of these allegations, but also all that can by reasonable and fair intendment be implied therefrom. We think it cannot be doubted that the allegations contained in the 12th paragraph of the complaint, if proved upon the trial, would be sufficient to establish an express waiver by the defendant of the stipulation in regard to plaintiff's total abstinence.⁴

Review Question 4. If asked to do so, could you formulate West's argument in the above case? Does it effectively concede that there was a condition in the contract? If not, exactly what is the argument that Clark is only entitled to the \$2 amount?

Review Question 5. Contractual conditions, you should understand by now, must usually be complied with strictly. Why then was Clark ultimately allowed to imbibe alcoholic beverages and still get a chance to collect? In discussing this point,

⁴ [Keefe-Davidson never proved to be financially viable. Rights to the book were acquired by Callaghan & Co. of Chicago, which published a second edition in 1912, the same year Keefe-Davidson went bankrupt. West Publishing put out a new edition of *Clark on Contracts* in 1904, though he was no longer involved in the work. *Clark and Marshall on Corporations* was later taken over by California law professor Henry Winthrop Ballantine, with the work known as *Ballantine on Corporations*,. One of its descendants is *Ballantine & Sterling: California Corporation Laws*, which is still a highly regarded and popular text for practitioners. More information can be found in Robert W. Jarvis, *John B. West, Founder of West Publishing Co.*, 50 AM. J. LEG. HIST. 1 (2010).—Eds.]

the court says refers to West’s “waiver.” What does *waiver* mean generally? What specific actions qualified as a waiver in *Clark v. West*?

ACME MARKETS, INC. v. FEDERAL ARMORED EXPRESS, INC.

Superior Court of Pennsylvania
437 Pa. Super. 41, 648 A.2d 1218 (1994)

HESTER, J:

Acme Markets, Inc., appeals from the order entered in the Court of Common Pleas of Montgomery County on December 21, 1993, which granted Federal Armored Express, Inc. summary judgment. For the reasons set forth below, we reverse that order and remand the matter for further proceedings.

[Federal supplied armored-car services to Acme, for the transportation of Acme’s receipts to its bank. One day in the regular course of business Federal’s armored car arrived at the Acme store. A Federal employee entered and was handed \$62,544 in a “cashbag.” The Federal employee took the cash and started to leave the store, but was robbed before he could do so. The contract provided that Federal would be liable for any robbery after the money had been received and a receipt had been issued. Acme demanded that Federal cover the loss. Federal refused. Acme sued. Both parties moved for summary judgment.]

The fifth paragraph of the agreement provides, “Responsibility of Federal under this contract shall begin when said [cash]bags or packages have been accepted and receipted for by Federal or its authorized employees, and shall terminate upon delivery to consignee or upon return to shipper.” Federal claimed that it bore no responsibility for the loss since neither it nor any of its employees had accepted the bag or provided the necessary receipt prior to the robbery.

Federal acknowledged that one of its employees possessed appellant’s cashbag at the time of the robbery. In addition, Federal noted that neither party disputed the fact that the employee in question had not provided a receipt for the bag prior to its loss. Consequently, relying upon both the fifth paragraph of the agreement and an affidavit demonstrating that the receipt requirement conformed with the custom of the armored car industry, Federal requested the entrance of judgment in its favor. On December 21, 1993, the trial court concluded that the fifth paragraph constituted a condition precedent to Federal’s liability under the agreement. Thus, the court denied appellant’s summary judgment motion and granted Federal relief. This timely appeal followed.

Appellant asserts that the trial court erroneously concluded that the fifth paragraph of the agreement constituted a condition precedent to Federal's liability for the lost bag. Specifically, appellant argues that since the paragraph was not labeled a condition precedent and does not contain other language normally associated with such a condition, "there is no means by which to state with the certainty required by Pennsylvania law that it creates a condition precedent." We find appellant's claim devoid of merit.

Initially, we note that a condition precedent may be defined as a condition which must occur before a duty to perform under a contract arises. While the parties to a contract need not utilize any particular words to create a condition precedent, an act or event designated in a contract will not be construed as constituting one unless that clearly appears to have been the parties' intention. In addition, we note that the purpose of any condition set forth in a contract must be determined in accordance with the general rules of contractual interpretation. Those rules may be summarized as follows.

When construing agreements involving clear and unambiguous terms, this Court need only examine the writing itself to give effect to the parties' understanding. The court must construe the contract only as written and may not modify the plain meaning of the words under the guise of interpretation. When the terms of a written contract are clear, this Court will not re-write it to give it a construction in conflict with the accepted and plain meaning of the language used. Conversely, when the language is ambiguous and the intention of the parties cannot be reasonably ascertained from the language of the writing alone, the parol evidence rule does not apply to the admission of oral testimony to show both the intent of the parties and the circumstances attending the execution of the contract.

Creeks v. Creeks, 619 A.2d 754, 756 (Pa. Super. Ct. 1993).

In the present case, the contested paragraph indicates that Federal's responsibility under the contract "shall begin when bags or packages have been accepted and receipted for by Federal or its employees." Our reading of this plain language demonstrates that it clearly and unambiguously conditions Federal's performance under the contract upon both the acceptance of bags or packages and the granting of a receipt for them. Thus, it unquestionably delineates a condition precedent involving those requirements.

Since we have found that Federal's liability under the contract was subject to a condition precedent and neither party disputes that the receipt portion of the condition remained unfulfilled at the time of the robbery, we must determine whether satisfaction of that requirement may be excused. Apparently arguing that strict application of the condition would be unfair, appellant asserts that the receipt requirement was immaterial and could only be seen as incidental to the far more

significant satisfied requirement of possession and acceptance by Federal's employee of appellant's property.

Restatement (Second) of Contracts § 229 discusses the excuse of a condition to avoid unfairness in connection with its strict enforcement. More specifically, that section relates to the excuse of a condition leading to a forfeiture, a term referring to "the denial of compensation that results when the obligee loses his right to the agreed exchange after he has relied substantially, as by preparation or performance on the expectation of that exchange." Section 229 provides

To the extent that the non-occurrence of a condition would cause disproportionate forfeiture, a court may excuse the non-occurrence of that condition unless its occurrence was a material part of the agreed exchange.

Since Pennsylvania law "abhors forfeitures and penalties and enforces them with the greatest reluctance when a proper case is presented," *Fogel Refrigerator Co. v. Oteri*, 137 A.2d 225, 231 (Pa. 1958), section 229 is consistent with the law of this Commonwealth. Consequently, we will apply it in the present case.

There can be little doubt that the operation of the condition in question will lead to a forfeiture since the condition's nonoccurrence results in the denial of compensation for the loss of a cashbag possessed by Federal for transportation in accordance with the contract. Thus, the question becomes whether the forfeiture would be disproportionate.

In determining whether the forfeiture is "disproportionate," [the] court must weigh the extent of the forfeiture by the obligee against the importance to the obligor of the risk from which he sought to be protected and the degree to which that protection will be lost if the nonoccurrence of the condition is excused to the extent required to prevent forfeiture.

Restatement (Second) of Contracts § 229 cmt b.

In the present case, appellant obviously entered into the armored car service contract so that it would have a secure method of transporting cash and checks to the bank. Strict application of the condition precedent would result in the loss of appellant's ability to recover from Federal for the theft of the bag entrusted to Federal's care. Moreover, we believe that the receipting requirement was intended to provide Federal with proof that it accepted, at a specific time, a certain number of cashbags for shipment. Thus, in our opinion, the requirement probably was little more than an accounting device designed to track bags picked up in accordance with the agreement. Under such circumstances, the receipt primarily would serve to protect Federal rather than Acme from, among other things, theft by its own

employees and disputes regarding the number of bags accepted. Those are two risks not at issue herein.

While we believe that the receipt requirement probably was an accounting device which had little impact upon the situation presently at issue, our examination of the certified record reveals that it is devoid of any evidence demonstrating the requirement's actual purpose. Thus, even though we have speculated on the matter, the record is inadequate to determine whether our speculation is accurate. In view of the inadequate record, we may not conduct the critical weighing analysis required by the Restatement or determine whether fulfillment of the condition may be excused. Indeed, we note that the trial court erroneously believed that its analysis ended upon concluding that a receipt was required to fulfill the condition precedent. Thus, the court did not consider whether the forfeiture would be disproportionate, decide if the receipt requirement constituted a material part of the exchange, or require the parties to provide an adequate record either for resolving those issues or deciding whether summary judgment in favor of Federal would be appropriate. Accordingly, we must reverse the trial court's grant of summary judgment and remand the matter for further proceedings.

On remand, the trial court should conduct an evidentiary hearing to determine the purpose of the receipt requirement and engage in the necessary weighing analysis. In addition, the court should determine whether the contested requirement constituted a material part of the agreement. While this determination rests to a large extent on the analysis of the requirement's purpose, it also involves a consideration of the negotiations of the parties along with all other circumstances relevant to the formation of the contract or to the requirement itself, including the circumstances surrounding the theft.

Order reversed. Case remanded for further proceedings. Jurisdiction relinquished.

Review Question 6. Notice the statement that on remand of the *Acme Markets* case, "the trial court should conduct an evidentiary hearing to determine the purpose of the receipt requirement and engage in the necessary weighing analysis" for determining whether the forfeiture would be disproportionate. What kinds of evidence should the lawyers on both sides be tracking down in advance of the anticipated hearing before the trial judge on remand?

TOWN OF FAIRFIELD v. D'ADDARIO

Supreme Court of Connecticut
149 Conn. 358, 179 A.2d 826 (1961)

BALDWIN, C.J.

The town of Fairfield brought this action against F. Francis D'Addario, doing business as The D'Addario Construction Company, to recover \$5,750, with interest and attorneys' fees, expended by the town in the settlement of an action for personal injuries brought against it by Edmund Kant.

The material findings of the trial court can be stated in summary as follows: On February 10, 1951, the town entered into a contract with D'Addario to construct a sewerage system. The contract provided that D'Addario would indemnify the town against loss or damage arising out of any cause connected with the contract, save the town harmless from all claims and liability for any loss, damage or injury sustained by any person by reason of, or in any way arising out of, the contract, and defend any suit brought against the town by reason of, or connected with, the work or materials furnished.⁵ On May 11, 1953, Edmund Kant brought an action against the town to recover for personal injuries allegedly suffered by him on March 21, 1953, because of a defective highway in an area where D'Addario had been working. Kant alleged that the roadway was broken and uneven and contained a deep hole and depression, and also that a manhole cover was elevated above the road surface. A police investigation of the alleged occurrence was completed and a report made to the town counsel on or about May 14, 1953. This report called attention to D'Addario's operations on the highway and stated that the manhole referred to in Kant's complaint had been constructed by D'Addario. On June 2, 1953, the town counsel entered an appearance in court in Kant's action. The town failed to give D'Addario any notice of Kant's claim or of his suit until June 22, 1956, when the town requested that D'Addario assume the defense of Kant's action and hold the town harmless from all liability therefor. On several occasions thereafter, up to February 8, 1957, this request was repeated, but D'Addario refused. On February 8, 1957, the town stipulated with Kant that in his action a judgment of \$5750 would be entered in his favor.

⁵ [By the court:] "The Contractor shall pay and make good all losses or damages arising out of any cause connected with the Contract and shall indemnify and save harmless the Municipality from any and all claims and any and all liability or responsibility of every nature and kind for any loss, damage or injury which any person or persons may sustain or suffer by reason of or in anywise arising out of the Contract and shall defend every suit of any nature which may be brought against the Municipality or any of its officers or agents, by reason of, or connected with the work or materials furnished under the Contract and shall pay all costs and expenses of every kind, character, and nature whatsoever, accruing upon or arising out of the Contract."

On these facts, the court concluded that the Kant action arose out of the contract between the town and D'Addario, that D'Addario was prejudiced by reason of the fact that the town did not notify him of the Kant action until three years had elapsed, and that the notice given then was not given within a reasonable time. Judgment was rendered for D'Addario, and the town has appealed.

The crucial questions in the case are (1) whether the town was required, under the terms of the indemnity provision, to give any notice of Kant's action to D'Addario, and (2) whether, if it was, the notice given was timely.

The agreement contains no specific language requiring the town to give D'Addario notice of any action brought against it which it might claim arose out of the contract. But the parties could not have contemplated otherwise than that such notice would be given. The construction of the sewerage system was a broad undertaking necessitating the disturbance of highways for which the town was responsible. If the town was to have the full measure of protection which the indemnity provision afforded and D'Addario was to have the opportunity of effectively discharging his part of the obligation, notice to him was indispensable. "Conditions upon which the right to require performance of a contract obligation depends may often be implied where not to do so would defeat the clear intention of the parties and the object of the contract." *Rifkin v. Safenovitz*, 415, 40 A.2d 188 (Conn. 1944). The circumstances under which the contract was made, as well as all the other provisions of the contract, are determinative factors in ascertaining intent. *Avco Manufacturing Corp. v. Connelly*, 140 A.2d 479 (Conn. 1958).

The indemnity provision of this contract contemplated that suits might be brought against the town for highway defects which it could claim were caused by D'Addario. The town would have peculiar knowledge of these suits and therefore was obligated to notify D'Addario of them. It can be fairly implied that the giving of reasonable notice was a condition precedent to D'Addario's duty to defend and indemnify. 3 SAMUEL WILLISTON, *THE LAW OF CONTRACTS* § 887B (rev. ed. 1936). Furthermore, when a party to a contract assumes an express obligation to do certain things—in this case, to defend and indemnify the plaintiff—the law implies a corresponding obligation on the other party to allow him all reasonable opportunity to perform. *Rockwell v. New Departure Manufacturing Co.*, 128 A. 302 (Conn. 1926). The cooperation required may be, as in the instant case, the giving of timely notice. 3A ARTHUR L. CORBIN, *CORBIN ON CONTRACTS* 386 (1950); 3 WILLISTON, *supra*, § 887B.

Kant sued the town on May 11, 1953. The town did not inform D'Addario of the suit until June 22, 1956. He was entitled to employ his own counsel to investigate the facts and prepare his defense. He was not, as the town claims, required to accept a report, made to it three years before, of an investigation by its police department. An independent investigation by D'Addario three years after the occurrence would have been of little, if any, use in the defense against Kant's claims as to either liability or damages. The notice of Kant's action came altogether too late to be called reasonable.

That term is a relative one. Its meaning is affected by the circumstances under which it is called into use. *E. M. Loew's Enterprises, Inc. v. Surabian*, 153 A.2d 463 (1959). The notice was not timely in this case. The court did not err in rendering judgment for D'Addario.

There is no error.

Review Question 7. “Notice” is a condition precedent common to many contracts, including in many liability insurance policies. To what extent is a requirement of notice a trap for the unwary rather than an independently valuable right for the party with the right to be put on notice? Read UCC § 2-607 for a statutory example of notice as a condition precedent to a breach of contract claim. As a malpractice-avoiding lawyer handling contracts cases, should you be more afraid of section 2-607 or of the general breach-of-contract statute of limitations (which is commonly four years following accrual of the claim)?

Problems

Problem 19.1

Nephew, who is 18, has been admitted to several colleges but is thinking about bypassing college to become a pottery maker. Uncle promises Nephew that if he in fact goes to college instead, and graduates, Uncle will give him \$50,000. He adds that if Nephew graduates from Uncle's alma mater, Hearst College (where he has been admitted), he will give him \$100,000. Nephew decides to enroll at Hearst, but does not like it and transfers to the University of California, Sunnydale. Uncle makes no objection to him switching schools, instead telling him that Hearst “may not be for everybody.” Nephew graduates from UC Sunnydale, whereupon Uncle gives him \$50,000. Nephew asks for the whole \$100,000, claiming that Uncle waived the condition. What result and why?

Problem 19.2

Owner hires Architect to design and supervise construction of a small office building. Architect prepares the necessary plans and specifications. Owner hires Contractor at a total bid of \$8 million to build the project. The Owner-Contractor agreement specifies that Contractor will take its instructions from Architect on the project. It also provides that three quarters of the total contract price will be paid out

in progress payments during construction. The remaining one quarter will be paid after the conclusion of construction, “upon issuance of a written certificate by the Architect that all work has been done in full conformance with all plans and specifications and meets all contract requirements, such determination to be made solely by Architect.” The contract also says that “materials may be substituted for those specified only with prior written approval of Architect.”

The contract required that all pipe used in the building be a particular brand of high-quality pipe called “Reading.” Contractor instead uses “Kohler” brand pipe, which is generally considered to be equivalent. Architect does not learn of this until construction is complete and all of the pipe is buried inside the walls. Architect refuses to give a certificate, insisting that the work does not conform to her plans.

Contractor demands the remaining \$2 million payment from Owner. Owner refuses to pay Contractor until Contractor presents Architect’s certificate, which Architect refuses to give unless the pipe is replaced. Replacing the pipe will require demolition of much of the foundation and walls. Contractor sues. How will each side argue in favor of its preferred interpretation? Who has the better argument?

Problem 19.3

Sarah Bellum is a brilliant young legal scholar who is being recruited to teach at Cosmopolitan University School of Law. Sarah signs a contract to begin teaching at CUSL at an annual salary of \$300,000. The contract provides that Sarah’s employment will begin on August 1. It goes on to provide:

Prior to [August 1], the Employee [Sarah] shall provide to the Administration all documentation and other materials necessary to demonstrate that (1) he/she is an American citizen or otherwise authorized to engage in lawful employment in the United States; (2) he/she possesses a Juris Doctorate degree from an American Bar Association-accredited law school or an equivalent foreign law degree; and (3) he/she has been admitted to the practice of law in at least one American or foreign jurisdiction.

The contract also provides that no modification to the contract may be made except in writing signed by Sarah and by the Human Resources Vice President of Cosmopolitan U.

As of August 1, Sarah, who has been doing a lecture tour in the Far East, fails to supply any of these documents. She is, in fact, an American citizen, earned her J.D. with high honors from a top school, and is a member of the bar, and CUSL’s hiring committee has no reason to doubt those facts, but there is no documentation in the file.

On August 2, the Human Resources Vice President at CU notifies Sarah that the contract is terminated since she did not get her documents in by August 1. Sarah, who had turned down lucrative offers from many other elite schools—where it is now

too late to get a job for the year—sues. It becomes apparent that the reason that Sarah’s contract was terminated was because the CU administration had discovered a massive budget shortfall and that it no longer wanted to pay Sarah under the contract. What result and why?

Unit 20: Implied Terms

TERMS AND INTERPRETATION

Part Four

FOCUS OF THIS UNIT

By now you should understand the concept that what most non-lawyers think of as “the contract”—the written document—is only part of the larger “agreement” between the parties. Furthermore, this agreement is only part of that total web of obligations that *lawyers* call “the contract.” As you saw in the discussion of the parol evidence rule, oral terms agreed to by the parties may be part of the deal alongside the written contract document. But can terms become part of a contract if the parties have never addressed them at all? The answer, perhaps surprisingly, is yes. Two broad categories of “implied” terms exist that courts will insert into contracts even when the parties have not expressly agreed to them.

Terms Implied from the Parties’ Deal. It is axiomatic in modern contracts law that all contracts are, in some fashion, “incomplete.” That is, it would be extremely time-consuming and probably impossible to address, in advance, every possible issue that might someday come up under the contract. Certain things that the parties did not bother to discuss would almost certainly have been included in their contract if they had been asked about it. If, to take a simple example, a buyer in Manhattan purchases something from a seller in Brooklyn for “\$5,000,” the “\$” almost certainly is intended to refer to United States dollars, and not those of, say, Canada or Singapore. Although the parties never specified United States dollars, courts and other readers of the contract infer from the circumstances that this is what they meant. A contract for a restaurant meal likewise almost certainly implies a promise by the restaurant that its food is not poisonous; a contract for a new computer implies a promise that the item will actually work when it is delivered. Here is a classic formulation of implied terms by one British judge:

Prima facie that which in any contract is left to be implied and need not be expressed is something so obvious that it goes without saying; so that, if, while the parties were making their bargain, an officious bystander were to suggest some express provision for it in their agreement, they would testily suppress him with a common “Oh, of course!”

Southern Foundries (1926) Ltd v Shirlaw, [1939] 2 K.B. 206, 227. This definition is an unusually narrow one, as you may notice upon reading the materials below, but the basic idea is clear enough. If the parties would reasonably have expected an unstated term to be part of their agreement, that term will be part of the contract.

Terms Implied from Trade Custom. Many times parties to a contract are part of a trade or business culture where the members share certain understandings and have particular ways of doing things. Members of the building trades, for example, understand that when they specify “2 x 4 lumber” they actually mean lumber that is 1.5 inches by 3.5 inches; members of the precious metals trade know that when they specify “one ounce” of gold they mean one troy ounce, which is smaller than the everyday English system’s avoirdupois ounce of sixteen to a pound used outside the arena of precious metals and gemstones. Parties in a particular trade are assumed to operate against the background of all this trade usage and thus can be assumed to understand that their contract includes the ordinary terms that are usual in the trade. If parties wish to avoid trade usage terms, they must do so explicitly.

Default Terms Implied by Law. In many situations, the parties have not addressed an issue, but we do not know what terms these two parties would obviously have chosen. For example, suppose *A* contracts to buy *B*’s car. The parties have not specified whether the buyer is supposed to pick it up or the seller is supposed to deliver it. We cannot infer what they each actually intended, and they may now even disagree about what they intended. Nonetheless, if the seller fails to deliver the car and the buyer sues, a tribunal will have to decide the issue. In this situation, contract law has developed what are variously called “background” terms, “gap-filler” terms, or “default” terms. A default term in contract law—analogous to the default setting on a computer program—is a term that applies unless the parties elect otherwise. Thus, in the hypothetical above, the default rule is that when the parties have not specified otherwise in a sale of goods, the buyer would be responsible for picking up the car, and thus the seller has no obligation to deliver it. *See* UCC § 2-308(a) (“Unless otherwise agreed . . . the place for delivery of the goods is the seller’s place . . .”). Scores of these type of default terms exist in contract law.

Default terms in American law are generally set to mimic what *most* contracting parties would presumably want in *most* transactions. There is considerable scholarly debate about whether this is a good approach to the problem, and your professor may want to explore the issue with you in more detail. Assuming, however, that the defaults are set correctly, this system has the advantage of being more likely (though not certain) to carry out the intent of the particular parties to the dispute. If you consider the way purchasers usually buy things, for example, you will probably notice that most of the time the buyer picks things up from the seller. Getting things delivered is less common, and therefore a rule that specifies buyer pickup will likely fit a larger range of contracts. Parties who want delivery can change

the default rule by specifying delivery to the buyer. Thus, when a consumer buys goods online, the contract usually includes an express promise that the seller will deliver, either for free or for an additional charge.

These default terms are sometimes developed by courts as part of the common law, but are often set by statutes and treaties like the UCC and the CISG. Realize, however that there are a host of state and federal statutes that also create obligations the parties did not expressly intend.

Terms Implied by Law as Public Policy. While most implied terms are rooted in the parties' presumed intent, some terms are implied in law for public policy reasons. That is, they are terms that courts or statutes put into the parties' contract not to carry out their actual wishes in their own deal, but to enforce some overarching policy, such as ensuring contractual fairness or preventing overreaching. Such terms are imposed even when it is clear that none of the parties had any intention of including them in the contract. Again, many of these implied terms are statutory (and there are many such statutory examples in UCC Article 2), but others developed from case law. Lawyers in practice understand that these kind special rules are out there and tend to learn them in areas that impact their clients.

Cases and Materials

WOOD v. LUCY, LADY DUFF-GORDON

Court of Appeals of New York
222 N.Y. 88, 118 N.E. 214 (1917)

CARDOZO, J.

The defendant styles herself “a creator of fashions.” Her favor helps a sale. Manufacturers of dresses, millinery and like articles are glad to pay for a certificate of her approval. The things which she designs, fabrics, parasols and what not, have a new value in the public mind when issued in her name. She employed the plaintiff to help her to turn this vogue into money. He was to have the exclusive right, subject always to her approval, to place her endorsements on the designs of others. He was also to have the exclusive right to place her own designs on sale, or to license others to market them. In return, she was to have one-half of “all profits and revenues” derived from any contracts he might make. The exclusive right was to last at least one year from April 1, 1915, and thereafter from year to year unless terminated by notice of ninety days. The plaintiff says that he kept the contract on his part, and that the defendant broke it. She placed her indorsement on fabrics, dresses and millinery

without his knowledge, and withheld the profits. He sues her for the damages, and the case comes here on demurrer.

The agreement of employment is signed by both parties. It has a wealth of recitals. The defendant insists, however, that it lacks the elements of a contract. She says that the plaintiff does not bind himself to anything. It is true that he does not promise in so many words that he will use reasonable efforts to place the defendant's endorsements and market her designs. We think, however, that such a promise is fairly to be implied. The law has outgrown its primitive stage of formalism when the precise word was the sovereign talisman, and every slip was fatal. It takes a broader view today. A promise may be lacking, and yet the whole writing may be "instinct with an obligation," imperfectly expressed. *McCall Co. v. Wright*, 117 N.Y.S. 775 (Sup. Ct. App. Div. 1909); *Moran v. Standard Oil Co.*, 105 N.E. 217 (N.Y. 1914). If that is so, there is a contract.

The implication of a promise here finds support in many circumstances. The defendant gave an *exclusive* privilege. She was to have no right for at least a year to place her own endorsements or market her own designs except through the agency of the plaintiff. The acceptance of the exclusive agency was an assumption of its duties. *Phoenix Hermetic Co. v. The Filtrine Manufacturing Co.*, 150 N.Y.S. 193 (Sup. Ct. App. Div. 1914). We are not to suppose that one party was to be placed at the mercy of the other. *Hearn v. Stevens*, 97 N.Y.S. 566 (Sup. Ct. App. Div. 1906). Many other terms of the agreement point the same way. We are told at the outset by way of recital that "the said Otis F. Wood possesses a business organization adapted to the placing of such endorsements as the said Lucy, Lady Duff-Gordon has approved." The implication is that the plaintiff's business organization will be used for the purpose for which it is adapted. But the terms of the defendant's compensation are even more significant. Her sole compensation for the grant of an exclusive agency is to be one-half of all the profits resulting from the plaintiff's efforts. Unless he gave his efforts, she could never get anything. Without an implied promise, the transaction cannot have such business "efficacy as both parties must have intended that at all events it should have." *The Moorcock*, 14 P. D. 64, 68 (C.A. 1889). But the contract does not stop there. The plaintiff goes on to promise that he will account monthly for all moneys received by him, and that he will take out all such patents and copyrights and trademarks as may in his judgment be necessary to protect the rights and articles affected by the agreement. It is true, of course, as the Appellate Division has said, that if he was under no duty to try to market designs or to place certificates of indorsement, his promise to account for profits or take out copyrights would be valueless. But in determining the intention of the parties, the promise has a value. It helps to enforce the conclusion that the plaintiff had some duties. His promise to pay the defendant one-half of the profits and revenues resulting from the exclusive agency and to render accounts monthly, was a promise to use reasonable efforts to bring

profits and revenues into existence. For this conclusion, the authorities are ample. See, e.g., *Wilson v. The Mechanical Orguinette Co.*, 63 N.E. 550 (N.Y. 1902).

The judgment of the Appellate Division should be reversed, and the order of the Special Term affirmed, with costs in the Appellate Division and in this court.

CUDDEBACK, McLAUGHLIN and ANDREWS, JJ., concur.

HISCOCK, Ch. J., CHASE and CRANE, JJ., dissent.

Excerpt from Karl N. Llewellyn, A Lecture on Appellate Advocacy, 29 U. CHI. L. REV. 627 (1962):

You must remember that Cardozo was a truly great advocate, and the fact that he became a great judge didn't at all change the fact that he was a great advocate. And if you will watch, in the very process of your listening to the facts [of *Wood v. Lucy, Lady Duff-Gordon*], you will find two things happening. The one is that . . . you arrive at the conclusion that the case has to come out one way. And the other is, that it fits into a legal frame that says, "How comfortable it will be, to bring it out that way. No trouble at all. No trouble at all."

[Llewellyn then walks through Cardozo's telling of the case facts.]

Now, is there any way to bring that case out, except one? Isn't it obvious that we are going to imply a promise on the part of the plaintiff which will satisfy the requirement of consideration and the decency of the situation?

All right, now try this: "The plaintiff in this action rests his case upon his own carefully prepared form agreement, which has as its first essence his own omission of any expression whatsoever of any obligation of any kind on the part of this same plaintiff. We thus have the familiar situation of a venture in which one party, here the defendant, has an asset, with what is, in advance, of purely speculative value. The other party, the present plaintiff, who drew the agreement, is a marketer eager for profit, but chary of risk. The legal question presented is whether the plaintiff, while carefully avoiding all risk in the event of failure, can nevertheless claim full profit in the event that the market may prove favorable in its response. The law of consideration joins with the principles of business decency in giving the answer. And the answer is no."

Review Question 1. *Wood v. Lucy, Lady Duff-Gordon* seems to be a case about consideration. Why on earth did your casebook authors put it here in a unit on implied terms?

Review Question 2. What was Judge Cardozo’s **factual** basis in *Wood v. Lucy, Lady Duff-Gordon* for implying a promise by Wood that was not actually stated in the written agreement between the parties? How, according to the Llewellyn excerpt above, should the case come out under established contract doctrine in the absence of an implied term? Which result do you believe would better effectuate the actual intent of the parties?

Review Question 3. In his book, *Framing Contract Law*, Professor Victor Goldberg explores the history of *Wood* and discovers that Otis Wood deliberately failed to put a best efforts clause into the Duff-Gordon contract because he had earlier been sued over a similar clause in a similar distribution clause with the creator of the hugely popular Kewpie Dolls. Does this fact affect your conclusion about whether Judge Cardozo was correct in his opinion? Why or why not?

MENDENHALL v. HANESBRANDS, INC.

U.S. District Court for the Middle District of North Carolina
856 F. Supp. 2d 717 (M.D.N.C. 2012)

BEATY, C.J.

[Rashard Mendenhall was a popular professional football player for the Pittsburgh Steelers. He signed a contract with Hanesbrands in 2008 under which he agreed to help advertise and promote products sold under the Champion trademark. Section 17(a) of the contract contained a “morals clause” that read as follows:

If Mendenhall commits or is arrested for any crime or becomes involved in any situation or occurrence (collectively, the “Act”) tending to bring Mendenhall into public disrepute, contempt, scandal, or ridicule, or tending to shock, insult or offend the majority of the consuming public or any protected class or group thereof, then we shall have the right to immediately terminate this Agreement. [Hanesbrands’] decision on all matters arising under this Section 17(a) shall be conclusive.

Beginning in 2011, Mendenhall began to use the Twitter social media platform to give his opinions on a range of issues. In 2011 he issued a series of tweets expressing statements many readers believed to be supportive of Osama bin Laden, the architect of the September 11, 2001 destruction of the World Trade Center, and questioning the U.S. government’s account of what happened. The tweets stirred up substantial public controversy, including both opposition to and support for Mendenhall’s statements.]

In a letter dated May 5, 2011, Hanesbrands’ Associate General Counsel indicated that it was Hanesbrands’ intent to terminate the Agreement effective Friday, May 13,

2011, pursuant to Paragraph 17(a) of the Agreement. Hanesbrands issued a public statement to ESPN, stating the following:

Champion is a strong supporter of the government's efforts to fight terrorism and is very appreciative of the dedication and commitment of the U.S. Armed Forces. Earlier this week, Rashard Mendenhall, who endorses Champion products, expressed personal comments and opinions regarding Osama bin Laden and the September 11 terrorist attacks that were inconsistent with the values of the Champion brand and with which we strongly disagreed. In light of these comments, Champion was obligated to conduct a business assessment to determine whether Mr. Mendenhall could continue to effectively communicate on behalf of and represent Champion with consumers.

While we respect Mr. Mendenhall's right to express sincere thoughts regarding potentially controversial topics, we no longer believe that Mr. Mendenhall can appropriately represent Champion and we have notified Mr. Mendenhall that we are ending our business relationship. Champion has appreciated its association with Mr. Mendenhall during his early professional football career and found him to be a dedicated and conscientious young athlete. We sincerely wish him all the best.

Mr. Mendenhall contended that Hanesbrands had no legal basis for terminating the Agreement. Hanesbrands contended that Mr. Mendenhall's May 2, 2011 tweets regarding the death of Osama bin Laden and the events of September 11, 2001, met the standard set forth in Section 17(a) and therefore Hanesbrands was within its right to terminate the Agreement.

Plaintiff filed this civil action.

Defendant contends that it was within its rights under the express terms of Section 17(a) to terminate the Agreement. Hanesbrands argues that its decision on all matters arising under Section 17(a) are to be deemed conclusive pursuant to the Section's express terms. It is for these reasons that Hanesbrands moves for Judgment on the Pleadings, asserting that "[b]ecause the undisputed terms of the Agreement vested Hanesbrands with the conclusive authority to terminate its contractual relationship with Mr. Mendenhall once it determined that his controversial and offensive statements tended to bring him into public disrepute, contempt, scandal or ridicule, or tended to shock, insult, or offend the majority of the consuming public, Mr. Mendenhall's breach of contract claim fails as a matter of law."

Plaintiff does not allege that the morals clause in Section 17(a) is unenforceable as a general matter. Rather, Plaintiff alleges that Hanesbrands' action in purporting to terminate the Agreement pursuant to Section 17(a) "violates the covenant of good faith and fair dealing implied in every contract."

Implied in all contracts governed by New York law “is a covenant of good faith and fair dealing in the course of contract performance,” which requires parties exercising discretion under the contract “not to act arbitrarily or irrationally in exercising that discretion.” *Dalton v. Educ. Testing Serv.*, 663 N.E. 2d 289 (N.Y. 1995). Courts have “equated the covenant of good faith and fair dealing with an obligation to exercise discretion reasonably and with proper motive, not arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties.” *Fishoff v. Coty Inc.*, 634 F.3d 647, 653 (2d Cir. 2011). The duty of good faith and fair dealing, however, is not without limits, and no obligation can be implied that would be inconsistent with other terms of the contractual relationship. A breach of the duty of good faith and fair dealing is considered a breach of contract.

In the present case, the Court finds that to the extent that the Agreement provides Hanesbrands with discretionary termination rights under Section 17(a), that discretion is subject to the implied covenant of good faith and fair dealing. As such, Hanesbrands’ exercise of any such discretion would include a promise on Hanesbrands’ part not to act arbitrarily, irrationally or unreasonably in exercising that discretion.

In alleging that Hanesbrands acted unreasonably, Plaintiff’s Complaint includes factual allegations that Hanesbrands purported to terminate the Agreement pursuant to Section 17(a) of the Agreement, while at the same time issuing a public statement to ESPN which indicated that Hanesbrands ended its business relationship with Mr. Mendenhall for another reason, that being because it strongly disagreed with Mr. Mendenhall’s comments. Since Section 17(a) is applicable only to the extent that Mr. Mendenhall became involved in an act that tended to “bring [him] into public disrepute, contempt, scandal or ridicule,” or tended “to shock, insult or offend the majority of the consuming public or any protected class or group thereof,” mere disagreement with Mr. Mendenhall’s comments would not have triggered Hanesbrands’ termination rights under Section 17(a). Therefore, from Plaintiff’s factual allegations, the Court can reasonably infer that Defendant’s actions in purporting to terminate the Agreement pursuant to Section 17(a), may have been unreasonable, in light of the covenant of good faith and fair dealing, if such action was based on mere disagreement with Plaintiff’s statements rather than on the applicability of Section 17(a)’s standard, as alleged by Plaintiff.

Defendant contends that even without reference to the news reports, the undisputed facts support dismissal of this action. Specifically, Defendant contends that Plaintiff admits in the Complaint that: (1) after posting the 9/11 Tweets, he received “negative reaction” and comments “opposed” to his views; (2) his statements were “controversial”; and (3) Plaintiff “apparently received enough criticism or ridicule in the two days that followed his posting of the 9/11 Tweets that he felt the

need to post a public ‘clarification’ to attempt to mollify anyone he had ‘unintentionally harmed’ by his statements.”

However, taking Plaintiff’s allegations as true, and drawing all reasonable inferences in Plaintiff’s favor, Plaintiff at no time in his Complaint made a blanket admission as to the nature of the public’s response. In fact, Plaintiff alleged that he received supportive tweets from members of the public in response to his comments.

Therefore, the Court finds that a dispute of fact exists between the parties as to the nature of the public’s response to Plaintiff’s May 2, 2011 tweets. Furthermore, based on Plaintiff’s allegations, the Court finds that, at this early stage of the proceedings, Plaintiff has stated at the very least a plausible claim for breach of contract based on the implied covenant of good faith and fair dealing. To find otherwise would require the Court to impermissibly draw inferences in Defendant’s favor.

Defendant’s Motion for Judgment on the Pleadings will be DENIED.

Review Question 4. The contract in *Mendenhall* specifically provided that Hanesbrands’ decision “on all matters arising under this Section 17(a) shall be conclusive.” Why put that language in there? Why didn’t the contract say that Hanesbrands’ decision would be valid “if a court of competent jurisdiction determines that Hanesbrands was acting in good faith for a valid reason”?

Review Question 5. Is the *Mendenhall* court implying the “good faith” term because it thinks that is what the parties (including Hanesbrands) intended, or because it is a term that should apply whether the parties want it to or not?

Review Question 6. What ideas would you, as a transactional lawyer representing Hanesbrands, recommend to your client in order to get the “shall be conclusive” clause enforceable or otherwise reach the result desired by Hanesbrands?

NANAKULI PAVING AND ROCK CO. v. SHELL OIL CO.

United States Court of Appeals for the Ninth Circuit
664 F.2d 772 (9th Cir. 1981)

HOFFMAN, D.J.¹

[Nanakuli was the smaller of the two major paving contractors in Hawaii. To make asphalt paving, it had to purchase “paving asphalt”—in reality, a thick, black, sticky petroleum byproduct technically called “bitumen” —from an oil company and “aggregate,” a mixture of rock and sand, from local quarries. As of 1969, there were two paving asphalt suppliers on Oahu, Shell (which supplied Nanakuli) and Chevron (which supplied Nanakuli’s chief competitor, HB).

In the years leading up to 1969, Shell and Nanakuli developed a close relationship, since Nanakuli was Shell’s only big customer in Hawaii and was very interested in helping it to grow. In 1969, Shell and Nanakuli entered into a 7-year contract under which Nanakuli agreed to buy all of its requirements of paving asphalt from Shell, and Shell agreed to sell Nanakuli as much as it needed. The contract provided that Nanakuli would pay Shell’s “posted price”—i.e., the price Shell would generally charge customers less a specific discount per ton negotiated with Nanakuli. Because paving asphalt is derived from oil, and oil prices fluctuate, Shell’s posted price would fluctuate more or less directly with crude oil prices. For the few decades before 1969, oil prices had been steadily declining in inflation-adjusted terms, and had generally moved in the \$2 to \$3 per barrel range.

In the wake of the Yom Kippur War, the Organization of Petroleum Exporting Countries—in retaliation for the U.S. government’s support of Israel—unilaterally imposed a 70% price increase in crude oil in the fall of 1973, raising it to over \$5 a barrel. The price continued to rise steadily; within the year the price would be \$12. Prior to this “oil crisis” Nanakuli had bid on major public works projects at a fixed price, and those contracts did not permit price adjustments for any higher costs Nanakuli might incur. Thus, when Shell in January 1974 raised its posted price from \$44 to \$76 a ton (a 72% increase) Nanakuli was faced with substantial losses on these government contracts for which it had not yet purchased paving asphalt. It demanded that Shell afford it “price protection,” that is, that Shell would continue to provide all

¹ [While all cases reprinted in casebooks are more or less trimmed, please note that the surgery done on this opinion was unusually extensive. The unedited opinion would have run more than five times as long, and would have had 44 footnotes. The phrase “Shell and Nanakuli developed a close relationship” in the factual summary that follows, for example, condenses nearly ten pages of detailed facts and bits of evidence that occurred over more than a decade and that are spread in various places throughout the opinion. A full understanding of the case requires that it be read in its entirety, preferably in a comfortable chair in an area free from interruptions and with an appropriate beverage close at hand. For present purposes, we are giving you the key points here.—Eds.]

the paving asphalt necessary to perform these contracts at the old price. Shell refused. Nanakuli sued claiming that Shell breached the contract when it refused to offer price protection. The jury found for Nanakuli, but the judge dismissed the complaint on the ground that the price protection claim was directly contradicted by the pricing mechanism of the 1969 written contract. Nanakuli appealed.]

Nanakuli argues [that] all material suppliers to the asphaltic paving trade in Hawaii followed the trade usage of price protection and thus it should be assumed, under the UCC, that the parties intended to incorporate price protection into their 1969 agreement. This is so, Nanakuli continues, even though the written contract provided for price to be “Shell’s Posted Price at time of delivery,” F.O.B. Honolulu. Its proof of a usage that was incorporated into the contract is reinforced by evidence of the commercial context, which under the UCC should form the background for viewing a particular contract.

[Shell argued in response that (1) there was no such trade usage, and (2) even if there was, it could not be used to contradict the express written terms of the 1969 contract.]

The validity of the jury verdict in this case depends on four legal questions. First, how broad was the trade to whose usages Shell was bound under its 1969 agreement with Nanakuli: did it extend to the Hawaiian asphaltic paving trade [which would consider the practices of those who sold aggregate and other supplies to Nanakuli] or was it limited merely to the purchase and sale of asphalt, which would only include evidence of practices by Shell and Chevron? Second, were the two instances of price protection of Nanakuli by Shell in 1970 and 1971 waivers of the 1969 contract as a matter of law or was the jury entitled to find that they constituted a course of performance of the contract? Third, could the jury have construed an express contract term of Shell’s posted price at delivery as reasonably consistent with a trade usage and Shell’s course of performance of the 1969 contract of price protection, which consisted of charging the old price at times of price increases, either for a period of time or for specific tonnage committed at a fixed price in non-escalating contracts? Fourth, could the jury have found that good faith obliged Shell to at least give advance notice of a \$32 increase in 1974, that is, could they have found that the commercially reasonable standards of fair dealing in the trade in Hawaii in 1974 were to give some form of price protection?

We approach the first issue in this case mindful that an underlying purpose of the UCC as enacted in Hawaii is to allow for liberal interpretation of commercial usages. Code provides, “This chapter shall be liberally construed and applied to promote its underlying purposes and policies.” Haw. Rev. Stat. § 490:1-102(1).² Only three purposes are listed, one of which is “(t)o permit the continued expansion of commercial practices through custom, usage and agreement of the parties.” *Id.*

² [See UCC § 1-103 for the provision numbered section 1-102 at the time of this case. – Eds.]

§ 490:1-102(2)(b). The drafters of the Code explain:

This Act is drawn to provide flexibility so that, since it is intended to be a semipermanent piece of legislation, it will provide its own machinery for expansion of commercial practices. It is intended to make it possible for the law embodied in this Act to be developed by the courts in the light of unforeseen and new circumstances and practices.

. . . The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the Act as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.

. . . The Code seeks to avoid interference with evolutionary growth. . . .

This principle of freedom of contract is subject to specific exceptions found elsewhere in the Act. . . . (An example being the bar on contractual exclusion of the requirement of good faith, although the parties can set out standards for same.) . . . In this connection, Section 1-205 incorporating into the agreement prior course of dealing and usages of trade is of particular importance.

Id. cmt. 2-3. We read that to mean that courts should not stand in the way of new commercial practices and usages by insisting on maintaining the narrow and inflexible old rules of interpretation. We seek the definition of trade usage not only in the express language of the Code but also in its underlying purposes, defining it liberally to fit the facts of the particular commercial context here.

The Code defines usage of trade as “any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question.” *Id.* § 490:1-205(2).³ We understand the use of the word “or” to mean that parties can be bound by a usage common to the place they are in business, even if it is not the usage of their particular vocation or trade. That reading is borne out by the repetition of the disjunctive “or” in subsection 3, which provides that usages “in the vocation or trade in which they are engaged or of which they are or should be aware give particular meaning to and supplement or qualify terms of an agreement.” *Id.* § 490:1-205(3). The drafters’ Comments say that trade usage is to be used to reach the “commercial meaning of the agreement” by interpreting the language “as meaning what it may fairly be expected to mean to parties involved in the particular transaction in a given locality or in a given vocation or trade.” *Id.* cmt. 4. The inference of the two subsections and the Comment, read together, is that a usage need not necessarily be

³ [Current UCC § 1-303(c) now contains the definition of “usage of trade.” – Eds.]

one practiced by members of the party's own trade or vocation to be binding if it is so commonly practiced in a locality that a party should be aware of it.

Under pre-Code law, a trade usage was not operative against a party who was not a member of the trade unless he actually knew of it or the other party could reasonably believe he knew of it. White and Summers add:

This view has been carried forward by 1-205(3) [now 1-303(c) – *Eds.*]. . . . [U]sage of the trade is only binding on members of the trade involved or persons who know or should know about it. Persons who should be aware of the trade usage doubtless include those who regularly deal with members of the relevant trade, and also members of a second trade that commonly deals with members of a relevant trade (for example, farmers should know something of seed selling).

JAMES J. WHITE & ROBERT L. SUMMERS, UNIFORM COMMERCIAL Code § 12-6 at 371 (1972). Using that analogy, even if Shell did not “regularly deal” with aggregate supplies, it did deal constantly and almost exclusively on Oahu with one asphalt paver. It therefore should have been aware of the usage of Nanakuli and other asphaltic pavers to bid at fixed prices and therefore receive price protection from their materials suppliers due to the refusal by government agencies to accept escalation clauses. Therefore, we do not find the lower court abused its discretion or misread the Code as applied to the peculiar facts of this case in ruling that the applicable trade was the asphaltic paving trade in Hawaii.

Shell argued not only that the definition of trade was too broad, but also that the practice itself was not sufficiently regular to reach the level of a usage and that Nanakuli failed to show with enough precision how the usage was carried out in order for a jury to calculate damages. The extent of a usage is ultimately a jury question. The Code provides, “The existence and scope of such a usage are to be proved as facts.” Haw. Rev. Stat. § 490:1-205(2). The practice must have “such regularity of observance . . . as to justify an expectation that it will be observed.” The Comment explains:

The ancient English tests for “custom” are abandoned in this connection. Therefore, it is not required that a usage of trade be “ancient or immemorial,” “universal” or the like. . . . [Full] recognition is thus available for new usages and for usages currently observed by the great majority of decent dealers, even though dissidents ready to cut corners do not agree.

Id. cmt. 5.

Nanakuli went beyond proof of a regular observance. It proved and offered to prove that price protection was probably a universal practice by suppliers to the asphaltic paving trade [except for Shell itself] in 1969. Thus, there clearly was enough proof for a jury to find that the practice of price protection in the asphaltic paving

trade existed in Hawaii in 1969 and was regular enough in its observance to rise to the level of a usage that would be binding on Nanakuli and Shell.

[Nanakuli also showed that *after* 1969 Shell gave price protection to Nanakuli on two different occasions. The court concluded that this was evidence of “course of performance,” that is, the subsequent conduct the parties showed that they believed the price protection term was included in the contract.]

Perhaps one of the most fundamental departures of the Code from prior contract law is found in the parol evidence rule and the definition of an agreement between two parties. Under the UCC, an agreement goes beyond the written words on a piece of paper. “Agreement’ means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance” *Id.* § 490:1-201(3). Express terms, then, do not constitute the entire agreement, which must be sought also in evidence of usages, dealings, and performance of the contract itself. The purpose of evidence of usages, which are defined in the previous section, is to help to understand the entire agreement.

[Usages are] a factor in reaching the commercial meaning of the agreement which the parties have made. The language used is to be interpreted as meaning what it may fairly be expected to mean to parties involved in the particular commercial transaction in a given locality or in a given vocation or trade. . . . Part of the agreement of the parties . . . is to be sought for in the usages of trade which furnish the background and give particular meaning to the language used, and are the framework of common understanding controlling any general rules of law which hold only when there is no such understanding.

Id. § 490:1-205 cmt. 4.

A commercial agreement, then, is broader than the written paper and its meaning is to be determined not just by the language used by them in the written contract but

by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing.

Id. cmt. 1. Performance, usages, and prior dealings are important enough to be admitted always, even for a final and complete agreement; only if they cannot be reasonably reconciled with the express terms of the contract are they not binding on the parties.

The express terms of an agreement and an applicable course of dealing

or usage of trade shall be construed wherever reasonable as consistent with each other; but when such construction is unreasonable express terms control both course of dealing and usage of trade and course of dealing controls usage of trade.

Id. § 490:1-205(4).

Our study of the Code provisions and Comments, then, form the first basis of our holding that a trade usage to price protect pavers at times of price increases for work committed on nonescalating contracts could reasonably be construed as consistent with an express term of seller's posted price at delivery. Since the agreement of the parties is broader than the express terms and includes usages, which may even add terms to the agreement, and since the commercial background provided by those usages is vital to an understanding of the agreement, we follow the Code's mandate to proceed on the assumption that the parties have included those usages unless they cannot reasonably be construed as consistent with the express terms.

[The court goes through an exhaustive list of decisions in which courts "have been lenient in not ruling out consistent additional terms or trade usage for apparent inconsistency with express terms. The court refers, among others, to *Columbia Nitrogen Corp. v. Royster Co.*, 451 F.2d 3 (4th Cir. 1971) (holding that a negotiated contract that provided for price hikes when a commodity price rose but was silent about price decreases could be supplemented by a price reduction clause implied from trade usage); *Michael Schiavone & Sons, Inc. v. Securalloy Co.*, 312 F. Supp. 801 (D. Conn. 1970) (contract that specified delivery of "500 Gross ton" of stainless steel actually meant any some amount up not to exceed 500 Gross ton); *Decker Steel Co. v. Exchange National Bank*, 330 F.2d 82, 85 (7th Cir. 1964) (holding that contract specification of "36-inch-wide" steel included steel that was actually 37 inches wide); *Provident Tradesmens Bank & Trust Co. v. Pemberton*, 173 A.2d 780, 783-84 (Pa. Super. Ct. 1961) (note that specifically stated that no notice need be given before foreclosure held to include a right to notice); *A & G Construction Co. v. Reid Brothers Logging Co.*, 547 P.2d 1207 (Alaska 1976) (contract that specified that payment would be made only for "State accepted scale ticketed tonnage" held to require payment for tonnage not accepted by the State); *Modine Manufacturing Co. v. North East Independent School District*, 503 S.W.2d 833, 838 (Tex. Civ. App. 1974) (contract that required a certain air conditioning system have "not less than" a specified capacity was not breached by delivering system that actually provided less capacity than specified); *Warren's Kiddie Shoppe, Inc. v. Casual Slacks, Inc.*, 120 Ga. App. 578, 171 S.E.2d 643 (Ga. Ct. App. 1969) (contract that provided for delivery in "June-Aug" held breached by party who delivered all of the goods in August because trade usage required that most of the goods be shipped in June). The court acknowledges but finds unpersuasive two contrary cases, *Southern Concrete Services, Inc. v. Mableton Contractors, Inc.*, 407 F. Supp. 581 (N.D. Ga.1975), *aff 'd*, 569 F.2d 1154 (5th Cir.

1978) (unpublished opinion) (holding that a contract that provided for an express amount could not be modified by trade usage that the specified amounts were only “estimates”), and *Division of Triple T Service, Inc. v. Mobil Oil Corp.*, 304 N.Y.S.2d 191 (Sup. Ct.1969) [(contract that provided for termination of a franchise for any reason with 90 days ‘ notice could not be supplemented by term that required franchisor to have “cause” for the termination).]

Some guidelines can be offered as to how usage evidence can be allowed to modify a contract. First, the court must allow a check on usage evidence by demanding that it be sufficiently definite and widespread to prevent unilateral post-hoc revision of contract terms by one party. The Code’s intent is to put usage evidence on an objective basis. J. H. Levie, *Trade Usage and Custom Under the Common Law and the Uniform Commercial Code*, 40 N.Y.U. L. Rev. 1101, 1102 (1965), states:

When trade usage adds new terms to cover matters on which the agreement is silent the court is really making a contract for the parties, even though it says it only consulted trade usage to find the parties ‘ probable intent. There is nothing wrong or even unusual about this practice, which really is no different from reading constructive conditions into a contract. Nevertheless the court does create new obligations, and perhaps that is why the courts often say that usage . . . must be proved by clear and convincing evidence.

Although the Code abandoned the traditional common law test of nonconsensual custom and views usage as a way of determining the parties ‘ probable intent, thus abolishing the requirement that common law custom be universally practiced, trade usages still must be well settled.

Here, the express price term was “Shell’s Posted Price at time of delivery.” A total negation of that term would be that the buyer was to set the price. It is a less than complete negation of the term that an unstated exception exists at times of price increases, at which times the old price is to be charged, for a certain period or for a specified tonnage, on work already committed at the lower price on nonescalating contracts. Such a usage forms a broad and important exception to the express term, but does not swallow it entirely. Therefore, we hold that, under these particular facts, a reasonable jury could have found that price protection was incorporated into the 1969 agreement between Nanakuli and Shell and that price protection was reasonably consistent with the express term of seller’s posted price at delivery.

Because the jury could have found for Nanakuli on its price protection claim, we reverse the judgment of the District Court and reinstate the jury verdict for Nanakuli in the amount of \$220,800, plus interest according to law.

Review Question 7. So does *Nanakuli Paving* stand for the proposition that a contract doesn't necessarily mean what it says? If you represent Shell and you want to ensure that your client can actually rely on the price term, what could you do when drafting the contract to improve your client's position?

Prefatory Note on Implied Warranties. You were introduced earlier (in a unit covering “merchants” under the Uniform Commercial Code) to the concept of the implied warranty of merchantability—a contract term implied by law where the seller is a merchant. The *American Fertilizer* case that follows returns to that concept alongside another, sometimes overlapping UCC implied warranty, that of fitness for a particular purpose. As you read the case, pay careful attention to see if you can tell the difference between how the two types of implied contract terms come into existence and what each of them do.

AMERICAN FERTILIZER SPECIALISTS, INC. v. WOOD

Supreme Court of Oklahoma
1981 OK 116, 635 P.2d 592

LAVENDER, J.

Plaintiff, a dealer in agricultural fertilizer, brought suit on open account for fertilizer sold and delivered to defendant for use on defendant's grass lands. By way of defense, defendant alleges breach of an implied warranty of fitness for a particular purpose and breach of an implied warranty of merchantability under the Uniform Commercial Code—Sales.⁴

Plaintiff does not contest its status as a “merchant” within the meaning of § 2-104(1),⁵ but contends that defendant failed to meet its burden of proving a breach as

⁴ [By the court] 12A OKLA. STAT. § 2-101 *et seq.* (1971). Section 2-315 in pertinent part provides:

Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is . . . an implied warranty that the goods shall be fit for such purpose.

Section 2-314 insofar as is pertinent provides: “(1) Unless excluded or modified . . . a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind . . .

* * *

(2) Goods to be merchantable must be at least such as . . . (c) are fit for the ordinary purposes for which such goods are used . . .

⁵ [By the court] Section 2-104(1) provides: “Merchant” means a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the

to the accepted goods as is required by § 2-607(4),⁶ and failed to give the seller (plaintiff) timely notice thereof pursuant to § 2-607(3)(a),⁷ particularly in light of the provisions of § 1-204(2).⁸

In jury-waived civil actions trial court's findings have force and effect of the jury's verdict and when finding is general it is finding of every specific thing necessary to be found sustaining general judgment and such judgment will not be disturbed on appeal in the absence of legal errors, if there is any competent evidence reasonably tending to support the trial court's conclusion.

Defendant, a cattleman-rancher, had pursued a successful program of fertilizing his grass lands for fifteen to twenty years. In recent years, he had applied a fertilizer called 10-20-10 during the first of March each year with what he characterized as near perfect results. On March 4, 1978, defendant was approached by Crawford, a sales representative of plaintiff, to induce a sale by plaintiff to defendant of commercial fertilizer. Crawford suggested that defendant use Triple 19 fertilizer which he said would get better results, representing that it was less costly and better per unit.⁹

Defendant and Crawford inspected a tract of defendant's land known as the South Taylor Alfalfa 40. The tract had fescue and clovers on it which had started Spring growth. Crawford agreed that the land was ready to be fertilized and stated that his Triple 19 would do the job. The ground was moist and the temperature was normal for early March. Crawford was informed that defendant used the ground both for cattle grazing and for haying. Crawford recommended that the land be fertilized by application of 250 pounds per acre, the quantity which defendant had applied of 10-20-10 in past years. Defendant agreed to purchase Triple 19 fertilizer from plaintiff for application on 183 acres including the 40-acre tract, the fertilizer to be spread by Crawford. The fertilizer was spread on March 11. Defendant mailed a check

practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by the employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill."

⁶ [By the court] Section 2-607(4) provides: "The burden is on the buyer to establish any breach with respect to the goods accepted."

⁷ [By the court] Section 2-607(3)(a) provides: "Where a tender has been accepted . . . the buyer must within a reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy . . ."

⁸ [By the court] Section 1-204(2) provides: "What is a reasonable time for taking any action depends on the nature, purpose and circumstances of such action."

⁹ [The numbers represent the relative amounts of nitrogen, phosphorous, and potassium in the mixture. A triple-19 fertilizer thus has 19 pounds each of the three elements, as compared with a 10-20-10 mixture, which has nearly twice as much nitrogen and potassium, and slightly less phosphorous. Different mixtures of the three nutrients are used for different crops. – Eds.]

for the fertilizer to plaintiff on April 4, 1978. A second application of fertilizer was made on April 6. Based upon past experience, defendant expected visible results within three days from application; but observing none, he summoned two representatives of plaintiff for a meeting on April 22. One of the representatives agreed that the fertilizer was not doing what it was supposed to do and that “he” would make it right. Defendant stopped payment on the check on about April 16. Plaintiff did nothing further. Thereupon defendant contracted with another fertilizer company to apply Triple 17 to said lands, except for the 40-acre tract, with good results. The South Taylor Alfalfa 40 yielded only half the hay as in previous years, and less than adjoining lands which had no application of fertilizer at all. The cattle pastured on the lands fertilized with Triple 19 were adversely affected in that they suffered a condition not observed in defendant’s cattle pastured on the land in previous years. Defendant refused to pay plaintiff for the fertilizer.

Simmons testified for plaintiff, stating that in agriculture you cannot guarantee anything other than the analysis of units per hundred weight. He testified that there are something like 57 things that control the making of a crop, but none were identified, nor was there any testimony that any of them affected defendant’s hay crop. He further testified that within three weeks or 30 days from the application of Triple 19 the grass should look dark green and “come on.” A farmer who fertilizes expects to grow something, to get more growth, better quality, and more protein. If you get a good rain after fertilization, you should start getting some growth and the grass should start looking dark green within a week. After fertilization and rain, one should be able to look at the fertilized land and tell if the fertilizer is working. Simmons said that upon inspection he could not see any visible change between the fertilized and unfertilized property. When defendant asked Simmons what he thought of it, Simmons replied “it’s just not doing what it’s supposed to do,” also stating he would make it right. Without further detailing the evidence before the trial court, we have no hesitancy in holding there was competent evidence reasonably tending to support the trial court’s conclusion, and to support the judgment in favor of defendant on the ground of breach of implied warranty under both § 2-314 and § 2-315 of 12A O.S.1971.

The defendant not only had reason to know the particular purpose for which defendant required fertilizer, viz., to increase the quality and quantity of his grass crop, he relied upon plaintiff’s salesman’s skill and judgment to select and furnish suitable fertilizer. Defendant had been a satisfied and successful user of 10-20-10 fertilizer for many years. He had not heard of Triple 19 until the salesman suggested it to him, and in reliance upon the salesman’s representations that Triple 19 would get better results, would be less costly and better per unit, he contracted for the product.

The concept of “merchantability” referred to in § 2-314 connotes not best quality or perfection in detail, but it does require, at the very least, that the goods

operate for their ordinary purpose.

Where the seller is a merchant and the facts so warrant, there may be an implied warranty of merchantability and also one of fitness for the particular purpose.¹⁰

Having established the existence of the warranty, the buyer has the added burden of proving that the warranty was broken and that the breach of the warranty was the proximate cause of the loss sustained.¹¹

Plaintiff urges that where the buyer's proof is based upon speculation and conjecture, a mere showing of "poor results" from the use of the product falls short of meeting the established standard for proximate cause, citing the case of *Olin Mathieson Chemical Corp. v. Moushon*, 235 N.E.2d 263 (Ill. Ct. App. 1968). While we agree that the rule set forth in *Olin Mathieson* is a correct statement of the law, the case is clearly distinguishable from the case at bar. In *Olin Mathieson*, the buyer purchased explosives from the seller for blasting in a rock quarry. A mere showing on the part of the buyer of poor results as compared with prior detonations at the quarry did not establish that the explosive failed to measure up to an implied warranty of fitness for the purpose intended. As the Court observed: "It could also be that the poor results were caused by failing to remove the broken rock from the toe and the loading to within five feet of the top. There is even a possibility that the shot holes were improperly drilled or that a difference in the rock formation was the cause. We have no evidence in this record that anything was wrong with the explosive except by reasoning backward, i.e., the result was poor; therefore, something must have been wrong with the explosive. In view of the other possibilities this is not enough."

Facts may be proved by circumstantial, as well as by positive or direct evidence, and it is not necessary that the proof rise to that degree of certainty which will exclude every other reasonable conclusion than the one arrived at by the trier of

¹⁰ [By the court] See UCC § 2-315 cmt. 2, which states in part:

A "particular purpose" differs from the ordinary purpose for which the goods are used in that it envisages a specific use by the buyer which is peculiar to the nature of his business whereas the ordinary purposes for which goods are used are those envisaged in the concept of merchantability and go to uses which are customarily made of the goods in question. For example, shoes are generally used for the purpose of walking upon ordinary ground, but a seller may know that a particular pair was selected to be used for climbing mountains.

A contract may of course include both a warranty of merchantability and one of fitness for a particular purpose.

¹¹ [By the court] See UCC § 2-314 cmt. 13, which states, in part:

In an action based on breach of warranty, it is of course necessary to show not only the existence of the warranty but the fact that the warranty was broken and that the breach of the warranty was the proximate cause of the loss sustained.

the facts. It is only required that it appears more probable that the defendant's poor grass crop was the result of the failure of the fertilizer sold by plaintiff to defendant to nourish and enrich defendant's grass lands than any other possible cause. It has also been held that where the warranty was as to the ingredients of fertilizer, evidence of the effect of the fertilizer on crops was admissible in connection with proof of the kind of soil, manner of cultivation, accidents of season, and other pertinent facts to prove that it did not contain the ingredients stated or in the proportion specified.¹²

There was more than ample evidence from which the court below as the trier of the facts could reasonably infer that the fertilizer sold by the plaintiff to the defendant did not meet the prescribed standard of merchantability, was not fit for the ordinary purpose for which it was sold, and that the poor grass crop on defendant's lands was the proximate result thereof.

The next issue for consideration is whether under the facts and circumstances of this case the lapse of forty-two days from the date of the first application of fertilizer before notice of the breach was given constitutes a "reasonable time" under § 2-607(3)(a) of the Commercial Code. While the defendant testified that visible results from the application of fertilizer might be expected as early as three days after application, all of the witnesses testifying on the subject agreed that such results should be forthcoming within three weeks to thirty days. Thus there was competent evidence on the basis of which the court below could reasonably conclude that defendant should have discovered the breach of warranty within twelve days from the date of the giving of notice. In order for the buyer to avoid liability for the payment of goods accepted, he must notify the seller within a reasonable time after he discovers or should have discovered a breach of warranty. The notification may be either oral or in writing and is sufficient if it is informative to the seller of the general nature of the difficulty encountered with the warranted goods by the holding of a majority of the cases dealing with this subject.

In the case of *L.A. Green Seed Company of Arkansas v. Williams*, 438 S.W.2d 717 (Ark. 1969), the court said: "The purpose of the statutory requirement of notice to the seller of breach of warranty is to enable the seller to minimize damages in some manner, such as correcting the defect, and also to give the seller some immunity against stale claims. Of course, the sufficiency of notice and what is considered to be a reasonable time within which to give notice of breach of warranty are ordinarily questions of fact for the jury, based upon the circumstances in each case."

In the case before us, the elapsed time of twelve days from the date of the discovery by defendant of the defect in the product and the giving notice thereof to the plaintiff did not under the facts and circumstances of this case constitute untimely notice. "Discovery" that the fertilizer was not working was not a sudden

¹² [By the court] *Hampton Guano Co. v. Hill Live-Stock Co.*, 84 S.E. 774 (N.C. 1915).

event whose arrival could be anticipated or commemorated by the stroke of a clock. Rather, it was a gradual realization predicated upon day to day observation which when taking into account weather conditions and past experience with fertilizer led to the conclusion that the fertilizer was not performing in the manner reasonably to be expected.

Defendant's motion for additional attorney fees for services on appeal is authorized to be presented to the trial court.

The judgment of the trial court is affirmed.

Review Question 8. The fertilizer numbers noted in the opinion are a standardized means of representing the relative amounts of nitrogen, phosphorous, and potassium in the mixture. A triple-19 fertilizer thus has 19 pounds each of the three elements, as compared with a 10-20-10 mixture, which has nearly twice as much nitrogen and potassium, and slightly less phosphorous. Different mixtures of the three nutrients are used for different crops. In *American Fertilizer Specialists*, the fertilizer was to be applied to a field of fescue grass and clover. Using this example, can you articulate the difference between a breach of the warranty of merchantability (UCC § 2-314) and a breach the warranty of fitness for a particular purpose (UCC § 2-315)?

Review Question 9. Suppose you represent the seller, American Fertilizer, which does not want to face a merchantability claim or a fitness-for-a-particular purpose claim every time a farmer's crop fails. Consider UCC § 2-316. Could this provision help your client? How would you go about drafting the appropriate provisions in the contract?

Problems

Problem 20.1

Scheck owns a Burger Queen fast food restaurant franchise in the middle of Smallville (pop. 5,943). The franchise is held under a highly detailed 45-page called the “Franchise Agreement.” One term of the Agreement gives Scheck the right to operate a BQ franchise restaurant at the corner of Main and Elm in Smallville. The Agreement specifically goes on to provide, however, that “nothing contained herein shall be read to grant or imply that [Scheck] shall have any area, market, or territorial rights in such geographic area.”

Scheck has learned that BQ has just negotiated an agreement with Marryat Corp., a major national food-services company, to build a brand-new Burger Queen franchise right at the point where Main Street meets the Interstate, only a few blocks from Scheck’s store. Some Burger Queen employees tell Scheck that the company is hoping that Marryat ultimately acquire a substantial number of its outlets and that it will help the company get rid of older stores owned by small-town business people and increase the professionalism of the ultimate product.

When the sparkling new building opens in its prime location, it quickly picks up a huge share of the market. Scheck’s business plummets. The relatively few customers he gets, in fact, tell him that they came to his store because the lines at the one on the Interstate were too long. He sues, arguing that Burger Queen opened the new store knowing that it would drive him out of business, and thus violated its obligation of good faith. BQ points to the explicit language of the Agreement. What should each side argue, and who has the better argument?

Problem 20.2

Plumber is called to the residence of Homeowner, where moisture has been seeping into a ceiling. After examination, Plumber says that in her view, the problem likely lies in the pipes installed in the ceiling, and “you really ought to fix the pipes. I think that’s probably what’s going on.” She offers to replace the pipes for \$800, nearly all of which will go to her labor in cutting through the floor of the room above, replacing a few pipe joints, closing things back up, and putting the carpet back down. Because Homeowner is leaving for a 3-week vacation in Europe, he agrees to have the work done then and there. Plumber thereupon does the work, which takes several hours of her time. She replaces exactly what she said she would replace and returns everything neatly to the way it was. Homeowner pays her, and happily heads off on vacation.

Unfortunately, Plumber’s work does not fix the problem, which gets progressively worse. When Homeowner returns he finds flooding and substantial

damage to ceilings, walls, and floors that ultimately cost \$10,000 to repair. He sues Plumber. Plumber produces the estimate and shows that she did exactly what she promised to do and never made any guarantee to Homeowner that her work would actually fix the problem. Homeowner claims that there is an implied warranty in the repair contract that the repair will fix the problem. What result and why?

Problem 20.3

Patty's Party Supplies faxed a purchase order to Bart's Balloons for 70,000 balloons, "in an assortment of colors." Patty followed up her purchase order with a phone call to Bart: "It is especially important for me to get black balloons for use at 'Over the Hill' birthday parties." Bart said he should have no trouble filling the order. A few hours later, Bart faxed back a confirmation, stating, "Bart's Balloons will supply the balloons per the terms of your written purchase order in one week for \$3,500 (5 cents per balloon), payment due on delivery. Please confirm these terms by your signature below." Patty signed the confirmation form and faxed it back to Bart. Bart delivered the balloons on the due date, consisting entirely of round balloons, 10,000 each in colors of red, orange, yellow, green, blue, indigo, and violet (the literal colors of the rainbow). None of the balloons are black. The balloons are also round, while Patty had wanted "long" balloons, as she has many customers who are professional clowns who make balloon animals.

Assume that Patty has ordered balloons from Bart before on several occasions, and until now, her order has always been filled with long balloons instead of round ones. However, the custom in the party-supply industry is that an order for "balloons," if nothing more is said, means that the order is for a standard size of round balloon. What shape of balloons was Bart contractually obligated to provide to Patty? What color or colors of balloons? Make sure you consider UCC § 1-303 in connection with your answers to those questions.



**AMERICAN CONTRACT LAW
FOR A GLOBAL AGE**

**Chapter VII: Performance and
Breach**

Unit 21: Standards of Contract Performance

Unit 22: Excused Performance

An Introduction to PERFORMANCE AND BREACH

Assume now (1) that we have a valid contract, (2) that no defenses prevent the contract's enforcement, and (3) that we know exactly what the contract says and means. The next question a lawyer must be able to answer in a potential contract dispute is whether one or more of the parties has *breached* the contract. Any failure to do what a party has promised to do is a breach. Given the almost limitless number of potential terms to which parties can agree, the question of whether the party did what it was obligated to do will usually be highly fact-intensive.

All Breaches Aren't Created Equal? Finding that a party did not do what it was supposed to do does not end the inquiry. Every breach of contract entitles the non-breaching party to claim damages or some other remedy. But often the non-breaching party does not want to sue for damages, but it instead wants to cancel the contract. As you will see from the materials in this chapter, not all breaches allow the aggrieved party to do that. Determining whether a particular failure to perform will allow the other party to cancel the contract depends on the standard of performance we use to decide the question. American contract law sometimes allows a party to cancel the agreement no matter how small or unimportant the breach is, a standard that lawyers call *perfect tender*. But contract law also sometimes requires parties to accept and pay for a performance that is not exactly what was bargained for, a standard called *substantial performance*.

When Is Close Good Enough? An example may help to understand this distinction. You may recall the famous court case in Shakespeare's *Merchant of Venice* where the court holds that Shylock is entitled to take a "pound of flesh" from Antonio.¹ But he would, as Portia points out, breach the agreement himself if he took more or less than a pound. Does he have to remove exactly a pound—that is, 453.592 grams—or is there some amount of leeway? If he takes one pound "more or less," has he breached in a way that would allow Antonio to back out of the deal? Or would he just be liable for the additional damage caused by the additional flesh taken? These two standards and the rules for how they work and when they are used are the subject of the next unit.

Excuses, Excuses. Even when a party fails to perform substantially (or even at all), it still may not be liable for breach of contract. How can this happen? In some situations, the law will *excuse* a party who failed to perform. The second unit in this chapter, covering contract excuses, deals with exactly this situation. You will be introduced to doctrines known as "commercial impracticability" and "frustration of

¹ By this point, we hope you realize—even without reading the chapter on Remedies—that a contract permitting extraction of a pound of flesh in the event of a breach would be void as a matter of public policy. You did realize that, didn't you?

purpose” that allow even a deliberate contract breacher off the hook in certain circumstances.

Performance and Excuses Working Together. Good lawyers are adept at arguing their clients’ cases in the alternative, and the doctrines in this chapter are part of that tradition. Thus, the party who is faced with a claim for breach of contract may have three layers of response to extent that factual uncertainty permits: (1) The party may claim, as a factual matter, that it did exactly what it was obligated to do, so no breach occurred. (2) The party may claim in the alternative that it did not do *exactly* what it was obligated to do, but it came close enough that the other party is obliged to accept and pay for the “good enough” performance rendered. (3) Finally, the party may claim as an additional alternative that, even if it did not come close to doing what it was obligated to do, something happened that excused its performance. Prevailing on any of these three legal theories can lead to the same result—the defendant is not liable for damages.

Unit 21: Standards of Contract Performance

PERFORMANCE AND BREACH Part One

FOCUS OF THIS UNIT

When Does Breach Occur? Assume that two parties are in a valid contract, but one party now believes the other has breached the contract. How does a lawyer tell when a contract has been breached? Determining whether a breach has occurred requires a *standard* for what it means to perform. Put another way, a legal system could have a rule that says that to comply with a contract means one must do *exactly* what one promised to do, without any deviation whatsoever. On the other hand, a legal system could have a rule in which doing *pretty much* what one promised to do—getting close enough—is sufficient.

Perfect Tender. As it happens, contract law uses both of those rules. The first is called, in modern legal parlance, the “perfect tender” rule. If a party’s tender of performance fails in any way to meet the contract requirements, the party cannot recover under the contract.¹ Over the years this first approach tended to develop among merchants engaged in trade, where courts tended to put weight on the expertise of business people and tended to give them credit for saying exactly what they meant. In the words of a well-known British judge, in commercial transactions there is “no room” for things that “are almost the same, or which will do just as well.”

Substantial Performance. Side by side with this, however, was an approach that allowed for at least a little flexibility, especially in situations like construction where some deviations from almost inevitable. Thus, in cases like *Glacius v. Black*,

¹ [Although, as we will see later when we get to damages for breach, there are alternative theories on which a party that has not performed perfectly can still recover something. —Eds.]

50 N.Y. 145 (1872), it was held that “mere technical, inadvertent or unimportant omissions or defects” would not amount to a breach that would allow the other party to back out of the transaction. What counts as “technical, inadvertent or unimportant,” however, was a matter of some dispute, and can be so today. This approach is typically known as the “substantial performance” doctrine. The modern American common law of contracts frequently follows the substantial performance doctrine, so that close-enough performance is not a breach. If that approach strikes you as unfair to the party whose expectation is impaired, realize that courts are reluctant to determine that a failure of performance that causes substantial prejudice to the other party is “substantial performance” of the contract.

The UCC and Perfect Tender. When the Uniform Commercial Code was being drafted in the 1940s, however, merchants and the lawyers who represent them were adamant that the concept of “perfect tender” be included in the rules for sales of goods. This fact might surprise you if you would assume merchants would like a rule that allowed them to deliver things that did not quite meet the buyer’s specifications. Merchants, in fact, are virtually always both buyers *and* sellers of goods. In their “buyer” capacity, these merchants benefit from a strict perfect tender standard. They do *not* want to be bound to accept products from its suppliers that are *almost as good* as what it ordered. A computer manufacturer, for example, wants components that are exactly what it wanted so that it can ensure that its product does exactly what the manufacturer promises. Thus, the “perfect tender” rule has been enacted by statute for sales of goods—at least in a one-shot (or non-installment) sale. The perfect tender rule is now embodied in section 2-601 of the UCC, and you should now read that section.

If the perfect tender rule strikes you as too harsh for trivial non-conformity to the contract, realize that the rule is frequently blunted by some of the other doctrines we have studied, such as the duty of good faith. A buyer claiming breach for a trivial reason cannot in good faith use the trivial nonconformity as an excuse to escape the contract with the seller where the buyer’s real reason for wanting out is that it found a better price somewhere else. Another amelioration of the perfect tender rule is UCC section 2-508, which gives the seller of non-conforming goods an opportunity to “cure” the nonconformity in certain situations. Read section 2-508 to see the extent of a seller’s right to cure.

The perfect tender rule is not applied to *installment contracts*; that is, contracts where goods are delivered in separate lots instead of all at once. In such contracts, breach requires the occurrence of a defect that “substantially impairs the value of that installment and cannot be cured.” If you find that language to be much closer to the common-law substantial performance doctrine, then you are correct. Read section 2-612 of the UCC for the rule on breach of installment contracts.

Advantages and Disadvantages of Both Approaches. One advantage of the perfect tender rule is that the parties can clearly specify exactly what they want.

Another is that it provides a bright line that allows parties to avoid litigation. One serious disadvantage, however, is that a party may suffer an enormous loss over a relatively minor deviation. For example, in one New York case, *Dauchey v. Drake*, 85 N.Y. 407 (1881), a company that was supposed to place advertisements for a patent medicine (“Plantation Bitters & Sea Moss Farina”) in 1,075 newspaper wound up breaching its contract because it only succeeded in getting the ads into 1,022 of them. In a contemporaneous U.S. Supreme Court case, *Filley v. Pope*, 115 U.S. 213 (1885), the seller breached a contract for the sale of 500 tons of Scotch pig iron because the contract required shipment from Glasgow, but the ship actually sailed from Leith (a port the same distance from the factory as Glasgow). The shipment was a breach even though there was no evidence of any prejudice to the buyer. The substantial performance doctrine seems much more reasonable in the face of such a result.

This problem of strict compliance can be especially troublesome where one party is using a relatively minor failure to escape liability on some other ground, when a reasonable person ordinarily would have no objection. On the other hand, a looser standard can also be troublesome in that it may encourage shoddy performance. Contract law, as you will see in the materials that follow, is constantly navigating the tension between perfect-tender and substantial-performance standards.

Cases and Materials

SMITH v. BRADY

Court of Appeals of New York
17 N.Y. 173 (1858)

[Defendant had hired plaintiff contractor to build some cottages for \$4,900. The contract required a certificate from the architect that work had been done in conformance with the plans before final payment. After construction, the architect refused to give a certificate based on what the plaintiff claimed were “unreasonable and frivolous objections.” Defendant refused to pay make the final payment of \$2,295, and plaintiff sued. The trial court determined that the work was defective, but that it caused only about \$212 in damage to defendant, and that plaintiff had actually spent an extra \$295 on the project already. So the court awarded plaintiff \$1,934. Defendant appealed.]

COMSTOCK, J.²

It was one of the specifications of the contract that the “nailing joists” in the frames of the cottages were to be twelve inches apart, measuring from center to center. The defendant’s evidence tended to show that these joists were in fact placed sixteen inches apart; that, in consequence of this departure from the specification, the number of joists used in all the buildings was less by about two hundred than the contract called for; that this defect in the work affected the value, strength and substantial character of the buildings. It appeared, also, that there was a similar breach of contract in respect to the distances between the beams in the third floor of the houses, being in fact twenty-four inches apart, while the contract allowed only sixteen. To meet the defense so far as it depended on these particular departures from the contract, the plaintiff was allowed to call other mechanics and ask them as follows: “Are the houses without these deficient joists and beams, sufficiently strong for the character of the buildings?” The evidence being given tended to show that the houses were sufficiently strong, that the joists and beams were placed at distances customary in that neighborhood, and that the defendant really was not injured at all by this violation of the contract.

The defendant having chosen to require, in the plain letter of the contract, that there should be in each building a certain number of joists and beams placed at certain distances from each other, the plaintiff had no right to substitute another plan for this part of the work; nor could he justify his willful departure from the contract by the opinion of other builders, or by any custom whether local or general.

I suppose it will be conceded that everyone has a right to build his house, his cottage or his store after such a model and in such style as shall best accord with his notions of utility or be most agreeable to his fancy. The specifications of the contract become the law between the parties until voluntarily changed. If the owner prefers a plain and simple Doric column, and has so provided in the agreement, the contractor has no right to put in its place the more costly and elegant Corinthian. If the owner, having regard to strength and durability, has contracted for walls of specified materials to be laid in a particular manner, or for a given number of joists and beams, the builder has no right to substitute his own judgment or that of others. Having departed from the agreement, if performance has not been waived by the other party, the law will not allow him to allege that he has made as good a building as the one he engaged to erect. He can demand payment only upon and according to the terms of his contract, and if the conditions on which payment is due have not been performed, then the right to demand it does not exist. To hold a different doctrine would be simply to make another contract, and would be giving to parties an

² [Judge Comstock’s opinion is actually the second (or concurring) opinion printed under this case in the *New York Reports*. The opinion is, however, joined by all of the other judges on the court, making it the arguably controlling opinion. – Eds.]

encouragement to violate their engagements, which the just policy of the law does not permit.

Cases of this kind must not be confounded with others having, perhaps, a slight resemblance but no real analogy. No doubt a person may voluntarily accept a benefit under a contract of which the conditions precedent have not been performed by the other party, and he may do this in such circumstances that a new obligation to pay for the benefit will arise. Thus, if *A.* should agree to manufacture and deliver to *B.* a carriage of a particular kind and should make a different one, *B.* may elect whether he will take it or not. If he voluntarily accepts the article, he thereby either waives the objections which he might make to it and is liable to pay for it according to his contract, or a new assumpsit arises from the act of acceptance as though no previous agreement had existed

To conclude, there is, in a just view of the question, no hardship in requiring builders, like all other men, to perform their contracts in order to entitle themselves to payment, where the employer has agreed to pay only on that condition. It is true that such contracts embrace a variety of particulars, and that slight omissions and inadvertencies may sometimes very innocently occur. These should be indulgently regarded, and they will be so regarded by courts and juries. But there can be no injustice in imputing to the contractor a knowledge of what his contract requires, nor in holding him to a substantial performance. If he has stipulated for walls of a given material and with a hard inside finish, he knows what he is to do and must perform it. If he has engaged for a given number and size of windows, joists, beams and sills, he cannot, with the specifications before him, innocently depart from his contract.³ If he fails to perform when the requirement is plain, and when he can perform if he will, he has no right to call upon the courts to make a new contract for him; nor ought he to complain if the law leaves him without remedy.

The judgment should be reversed and a new trial granted.

Review Question 1. The *Smith v. Brady* opinion refers early on to “the plain letter of the contract,” and that “the plaintiff had no right to substitute another plan for this part of the work.” That sounds very much like a perfect-tender standard. Toward the end of the opinion, however, Judge Comstock described holding the contractor to “a substantial performance,” which is the looser performance standard. If you were a commercial litigator, could you use the facts and language in *Smith* as support for **both** standards? How?

³ [In other words, if you know what you are supposed to do, your failure to do what you know you are supposed to do cannot be “innocent” in the sense the court is using it. – Eds.]

JACOB & YOUNGS, INC. v. KENT

Court of Appeals of New York
230 N.Y. 239, 129 N.E. 889 (1921)

CARDOZO, J.

The plaintiff built a country residence for the defendant at a cost of upwards of \$77,000, and now sues to recover a balance of \$3,483.46, remaining unpaid. The work of construction ceased in June, 1914, and the defendant then began to occupy the dwelling. There was no complaint of defective performance until March, 1915. One of the specifications for the plumbing work provides that “all wrought iron pipe must be well galvanized, lap welded pipe of the grade known as ‘standard pipe’ of Reading manufacture.” The defendant learned in March, 1915, that some of the pipe, instead of being made in Reading, was the product of other factories. The plaintiff was accordingly directed by the architect to do the work anew. The plumbing was then encased within the walls except in a few places where it had to be exposed. Obedience to the order meant more than the substitution of other pipe. It meant the demolition at great expense of substantial parts of the completed structure. The plaintiff left the work untouched, and asked for a certificate that the final payment was due. Refusal of the certificate was followed by this suit.

The evidence sustains a finding that the omission of the prescribed brand of pipe was neither fraudulent nor willful. It was the result of the oversight and inattention of the plaintiff’s subcontractor. Reading pipe is distinguished from Cohoes pipe and other brands only by the name of the manufacturer stamped upon it at intervals of between six and seven feet. Even the defendant’s architect, though he inspected the pipe upon arrival, failed to notice the discrepancy. The plaintiff tried to show that the brands installed, though made by other manufacturers, were the same in quality, in appearance, in market value and in cost as the brand stated in the contract—that they were, indeed, the same thing, though manufactured in another place. The evidence was excluded, and a verdict directed for the defendant. The Appellate Division reversed, and granted a new trial.

We think the evidence, if admitted, would have supplied some basis for the inference that the defect was insignificant in its relation to the project. The courts never say that one who makes a contract fills the measure of his duty by less than full performance. They do say, however, that an omission, both trivial and innocent, will sometimes be atoned for by allowance of the resulting damage, and will not always be the breach of a condition to be followed by a forfeiture. The distinction is akin to that between dependent and independent promises, or between promises and conditions. Some promises are so plainly independent that they can never by fair construction be conditions of one another. Others are so plainly dependent that they must always be conditions. Others, though dependent and thus conditions when there

is departure in point of substance, will be viewed as independent and collateral when the departure is insignificant. Considerations partly of justice and partly of presumable intention are to tell us whether this or that promise shall be placed in one class or in another. The simple and the uniform will call for different remedies from the multifarious and the intricate. The margin of departure within the range of normal expectation upon a sale of common chattels will vary from the margin to be expected upon a contract for the construction of a mansion or a "skyscraper." There will be harshness sometimes and oppression in the implication of a condition when the thing upon which labor has been expended is incapable of surrender because united to the land, and equity and reason in the implication of a like condition when the subject-matter, if defective, is in shape to be returned. From the conclusion that promises may not be treated as dependent to the extent of their uttermost minutiae without a sacrifice of justice, the progress is a short one to the conclusion that they may not be so treated without a perversion of intention. Intention not otherwise revealed may be presumed to hold in contemplation the reasonable and probable. If something else is in view, it must not be left to implication. There will be no assumption of a purpose to visit venial faults with oppressive retribution.

Those who think more of symmetry and logic in the development of legal rules than of practical adaptation to the attainment of a just result will be troubled by a classification where the lines of division are so wavering and blurred. Something, doubtless, may be said on the score of consistency and certainty in favor of a stricter standard. The courts have balanced such considerations against those of equity and fairness, and found the latter to be the weightier. The decisions in this state commit us to the liberal view, which is making its way, nowadays, in jurisdictions slow to welcome it. Where the line is to be drawn between the important and the trivial cannot be settled by a formula. "In the nature of the case precise boundaries are impossible." 2 SAMUEL WILLISTON, LAW OF CONTRACTS § 841 (1926). The same omission may take on one aspect or another according to its setting. Substitution of equivalents may not have the same significance in fields of art on the one side and in those of mere utility on the other. Nowhere will change be tolerated, however, if it is so dominant or pervasive as in any real or substantial measure to frustrate the purpose of the contract. There is no general license to install whatever, in the builder's judgment, may be regarded as "just as good." The question is one of degree, to be answered, if there is doubt, by the triers of the facts and, if the inferences are certain, by the judges of the law. We must weigh the purpose to be served, the desire to be gratified, the excuse for deviation from the letter, the cruelty of enforced adherence. Then only can we tell whether literal fulfilment is to be implied by law as a condition. This is not to say that the parties are not free by apt and certain words to effectuate a purpose that performance of every term shall be a condition of recovery. That question is not here. This is merely to say that the law will be slow to impute the purpose, in the silence of the parties, where the significance of the default is grievously out of proportion to the oppression of the forfeiture. The willful

transgressor must accept the penalty of his transgression. For him there is no occasion to mitigate the rigor of implied conditions. The transgressor whose default is unintentional and trivial may hope for mercy if he will offer atonement for his wrong.

In the circumstances of this case, we think the measure of the allowance is not the cost of replacement, which would be great, but the difference in value, which would be either nominal or nothing. Some of the exposed sections might perhaps have been replaced at moderate expense. The defendant did not limit his demand to them, but treated the plumbing as a unit to be corrected from cellar to roof. In point of fact, the plaintiff never reached the stage at which evidence of the extent of the allowance became necessary. The trial court had excluded evidence that the defect was unsubstantial, and in view of that ruling there was no occasion for the plaintiff to go farther with an offer of proof. We think, however, that the offer, if it had been made, would not of necessity have been defective because directed to difference in value. It is true that in most cases the cost of replacement is the measure. The owner is entitled to the money which will permit him to complete, unless the cost of completion is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value. Specifications call, let us say, for a foundation built of granite quarried in Vermont. On the completion of the building, the owner learns that through the blunder of a subcontractor part of the foundation has been built of granite of the same quality quarried in New Hampshire. The measure of allowance is not the cost of reconstruction. "There may be omissions of that which could not afterwards be supplied exactly as called for by the contract without taking down the building to its foundations, and at the same time the omission may not affect the value of the building for use or otherwise, except so slightly as to be hardly appreciable." *Handy v. Bliss*, 90 N.E. 864 (N.Y. 1910). The rule that gives a remedy in cases of substantial performance with compensation for defects of trivial or inappreciable importance, has been developed by the courts as an instrument of justice. The measure of the allowance must be shaped to the same end.

The order should be affirmed, and judgment absolute directed in favor of the plaintiff upon the stipulation, with costs in all courts.

McLAUGHLIN, J., dissenting.

I dissent. The plaintiff did not perform its contract. Its failure to do so was either intentional or due to gross neglect which, under the uncontradicted facts, amounted to the same thing, nor did it make any proof of the cost of compliance, where compliance was possible.

Under its contract it obligated itself to use in the plumbing only pipe (between 2,000 and 2,500 feet) made by the Reading Manufacturing Company. The first pipe delivered was about 1,000 feet and the plaintiff's superintendent then called the

attention of the foreman of the subcontractor, who was doing the plumbing, to the fact that the specifications annexed to the contract required all pipe used in the plumbing to be of the Reading Manufacturing Company. They then examined it for the purpose of ascertaining whether this delivery was of that manufacture and found it was. Thereafter, as pipe was required in the progress of the work, the foreman of the subcontractor would leave word at its shop that he wanted a specified number of feet of pipe, without in any way indicating of what manufacture. Pipe would thereafter be delivered and installed in the building, without any examination whatever. Indeed, no examination, so far as appears, was made by the plaintiff, the subcontractor, defendant's architect, or anyone else, of any of the pipe except the first delivery, until after the building had been completed. Plaintiff's architect then refused to give the certificate of completion, upon which the final payment depended, because all of the pipe used in the plumbing was not of the kind called for by the contract. After such refusal, the subcontractor removed the covering or insulation from about 900 feet of pipe which was exposed in the basement, cellar and attic, and all but 70 feet was found to have been manufactured, not by the Reading Company, but by other manufacturers, some by the Cohoes Rolling Mill Company, some by the National Steel Works, some by the South Chester Tubing Company, and some which bore no manufacturer's mark at all. The balance of the pipe had been so installed in the building that an inspection of it could not be had without demolishing, in part at least, the building itself.

I am of the opinion the trial court was right in directing a verdict for the defendant. The plaintiff agreed that all the pipe used should be of the Reading Manufacturing Company. Only about two-fifths of it, so far as appears, was of that kind. If more were used, then the burden of proving that fact was upon the plaintiff, which it could easily have done, since it knew where the pipe was obtained. The question of substantial performance of a contract of the character of the one under consideration depends in no small degree upon the good faith of the contractor. If the plaintiff had intended to, and had complied with the terms of the contract except as to minor omissions, due to inadvertence, then he might be allowed to recover the contract price, less the amount necessary to fully compensate the defendant for damages caused by such omissions. But that is not this case. It installed between 2,000 and 2,500 feet of pipe, of which only 1,000 feet at most complied with the contract. No explanation was given why pipe called for by the contract was not used, nor was any effort made to show what it would cost to remove the pipe of other manufacturers and install that of the Reading Manufacturing Company. The defendant had a right to contract for what he wanted. He had a right before making payment to get what the contract called for. It is no answer to this suggestion to say that the pipe put in was just as good as that made by the Reading Manufacturing Company, or that the difference in value between such pipe and the pipe made by the Reading Manufacturing Company would be either "nominal or nothing." Defendant contracted for pipe made by the Reading Manufacturing Company. What his reason

was for requiring this kind of pipe is of no importance. He wanted that and was entitled to it. It may have been a mere whim on his part, but even so, he had a right to this kind of pipe, regardless of whether some other kind, according to the opinion of the contractor or experts, would have been “just as good, better, or done just as well.” He agreed to pay only upon condition that the pipe installed were made by that company and he ought not to be compelled to pay unless that condition be performed. The rule, therefore, of substantial performance, with damages for unsubstantial omissions, has no application.

Hiscock, Ch. J., Hogan and Crane, JJ., concur with Cardozo, J.; Pound and Andrews, JJ., concur with McLaughlin, J.

Review Question 2. Judge McLaughlin’s dissent says that “[i]f the plaintiff [contractor] had intended to, and had complied with the terms of the contract except as to minor omissions, due to inadvertence, then he might be allowed to recover the contract price, less the amount necessary to fully compensate the defendant for damages caused by such omissions.” Wouldn’t Judge Cardozo agree with that statement as an accurate articulation of the substantial performance doctrine? If both judges are applying the same basic rule, then how can you explain their reaching such different results?

Review Question 3. Suppose that Mr. Kent was, in fact, the president of the Reading Pipe Company. Should that change the outcome of the case? Why or why not?

O.W. GRUN ROOFING & CONSTRUCTION CO. v. COPE
Court of Civil Appeals of Texas, Fourth District—San Antonio
529 S.W.2d 258 (Tex. Civ. App. 1975)

CADENA, J.

Plaintiff, Mrs. Fred M. Cope, sued defendant, O.W. Grun Roofing & Construction Co., to set aside a mechanic’s lien⁴ filed by defendant and for damages

⁴ [When a contractor does work on a piece of real property, statutes in most states allow it to recover money owed from whoever owns the property, not merely from the person who hired the contractor. Thus, if a subcontractor is not paid for work, the prime contractor that hired it is liable, but so can be the owner who hired the prime contractor. If the property is sold, the new owner will also be liable based on a “mechanic’s lien” having been filed in the real property records. The terminology—still very much in use by lawyers today—came about because in the 19th century all skilled workers were referred to as “mechanics.” The lien is not itself a lawsuit; it simply attaches to the property until

in the sum of \$1,500 suffered by plaintiff as a result of the alleged failure of defendant to perform a contract calling for the installation of a new roof on plaintiff's home. Defendant, in addition to a general denial, filed a cross-claim for \$648, the amount which plaintiff agreed to pay defendant for installing the roof, and for foreclosure of the mechanic's lien on plaintiff's home.

Following trial to a jury, the court below entered judgment awarding plaintiff \$122.60 as damages for defendant's failure to perform the contract; setting aside the mechanic's lien; and denying defendant recovery on its cross-claim. It is from this judgment that defendant appeals.

The written contract required defendant to install a new roof on plaintiff's home for \$648. The contract describes the color of the shingles to be used as "russet glow," which defendant defined as a "brown varied color." Defendant acknowledges that it was his obligation to install a roof of uniform color.

After defendant had installed the new roof, plaintiff noticed that it had streaks which she described as yellow, due to a difference in color or shade of some of the shingles. Defendant agreed to remedy the situation and he removed the nonconforming shingles. However, the replacement shingles do not match the remainder, and photographs introduced in evidence clearly show that the roof is not of a uniform color. Plaintiff testified that her roof has the appearance of having been patched, rather than having been completely replaced. According to plaintiff's testimony, the yellow streaks appeared on the northern, eastern and southern sides of the roof, and defendant only replaced the non-matching shingles on the northern and eastern sides, leaving the southern side with the yellow streaks still apparent. The result is that only the western portion of the roof is of uniform color.

When defendant originally installed the complete new roof, it used 24 "squares" of shingles. In an effort to achieve a roof of uniform color, five squares were ripped off and replaced. There is no testimony as to the number of squares which would have to be replaced on the southern, or rear, side of the house in order to eliminate the original yellow streaks. Although there is expert testimony to the effect that the disparity in color would not be noticeable after the shingles have been on the roof for about a year, there is testimony to the effect that, although some nine or ten months have elapsed since defendant attempted to achieve a uniform coloration, the roof is still "streaky" on three sides. One of defendant's experts testified that if the shingles are properly applied the result will be a "blended" roof rather than a streaked roof.

In view of the fact that the disparity in color has not disappeared in nine or ten months, and in view of the fact that there is testimony to the effect that it would be

such time as the contractor sues to enforce it or, as here, the owner sues to have the encumbrance on the property removed. – Eds.]

impossible to secure matching shingles to replace the nonconforming ones, it can reasonably be inferred that a roof of uniform coloration can be achieved only by installing a completely new roof.

The evidence is undisputed that the roof is a substantial roof and will give plaintiff protection against the elements.

The principle which allows recovery for part performance in cases involving dependent promises may be expressed by saying that a material breach or a breach which goes to the root of the matter or essence of the contract defeats the promisor's claim despite his part performance, or it may be expressed by saying that a promisor who has substantially performed is entitled to recover, although he has failed in some particular to comply with his agreement. The latter mode of expressing the rule is generally referred to as the doctrine of substantial performance and is especially common in cases involving building contracts, although its application is not restricted to such contracts.

It is difficult to formulate definitive rule for determining whether the contractor's performance, less than complete, amounts to "substantial performance," since the question is one of fact and of degree, and the answer depends on the particular facts of each case. But, although the decisions furnish no rule of thumb, they are helpful in suggesting guidelines. One of the most obvious factors to be considered is the extent of the nonperformance. The deficiency will not be tolerated if it is so pervasive as to frustrate the purpose of the contract in any real or substantial sense. The doctrine does not bestow on a contractor a license to install whatever is, in his judgment, "just as good." The answer is arrived at by weighing the purpose to be served, the desire to be gratified, the excuse for deviating from the letter of the contract and the cruelty of enforcing strict adherence or of compelling the promisee to receive something less than for which he bargained. Also influential in many cases is the ratio of money value of the tendered performance and of the promised performance. In most cases the contract itself at least is an indication of the value of the promised performance, and courts should have little difficulty in determining the cost of curing the deficiency. But the rule cannot be expressed in terms of a fraction, since complete reliance on a mathematical formula would result in ignoring other important factors, such as the purpose which the promised performance was intended to serve and the extent to which the nonperformance would defeat such purpose, or would defeat it if not corrected. *See generally* 3A ARTHUR L. CORBIN, CORBIN ON CONTRACTS §§ 700-07 (1960).

Although definitions of "substantial performance" are not always couched in the same terminology and, because of the facts involved in a particular case, sometimes vary in the recital of the factors to be considered, the following definition by the Commission of Appeals in *Atkinson v. Jackson Bros.*, 270 S.W. 848, 849 (Tex. Comm. App. 1925), is a typical recital of the constituent elements of the doctrine:

To constitute substantial compliance the contractor must have in good faith intended to comply with the contract, and shall have substantially done so in the sense that the defects are not pervasive, do not constitute a deviation from the general plan contemplated for the work, and are not so essential that the object of the parties in making the contract and its purpose cannot, without difficulty, be accomplished by remedying them. Such performance permits only such omissions or deviations from the contract as are inadvertent and unintentional, are not due to bad faith, do not impair the structure as a whole, and are remediable without doing material damage to other parts of the building in tearing down and reconstructing.

See also Dupuy v. Shilling, 27 S.W.2d 323, 325 (Tex. Civ. App. 1930); 10 TEX. JUR. 2D, *Building Contracts* § 21; 13 AM. JUR. 2D, *Building and Construction Contracts* §§ 41-43.

What was the general plan contemplated for the work in this case? What was the object and purpose of the parties? It is clear that, despite the frequency with which the courts speak of defects that are not “pervasive,” which do not constitute a “deviation from the general plan,” and which are “not so essential that the object of the parties in making the contract and its purpose cannot, without difficulty, be accomplished by remedying them,” when an attempt is made to apply the general principles to a particular case difficulties are encountered at the outset. Was the general plan to install a substantial roof which would serve the purpose which roofs are designed to serve? Or, rather, was the general plan to install a substantial roof of uniform color? Was the object and purpose of the contract merely to furnish such a roof, or was it to furnish such a roof which would be of a uniform color? It should not come as a shock to anyone to adopt a rule to the effect that a person has, particularly with respect to his home, to choose for himself and to contract for something which exactly satisfies that choice, and not to be compelled to accept something else. In the matter of homes and their decoration, as much as, if not more than, in many other fields, mere taste or preference, almost approaching whimsy, may be controlling with the homeowner, so that variations which might, under other circumstances, be considered trifling, may be inconsistent with that “substantial performance” on which liability to pay must be predicated. Of mere incompleteness or deviations which may be easily supplied or remedied after the contractor has finished his work, and the cost of which to the owner is not excessive and readily ascertainable, present less cause for hesitation in concluding that the performance tendered constitutes substantial performance, since in such cases the owner can obtain complete satisfaction by merely spending some money and deducting the amount of such expenditure from the contract price.

In the case before us there is evidence to support the conclusion that plaintiff can secure a roof of uniform coloring only by installing a completely new roof. We

cannot say, as a matter of law, that the evidence establishes that in this case that a roof which so lacks uniformity in color as to give the appearance of a patch job serves essentially the same purpose as a roof of uniform color which has the appearance of being a new roof. We are not prepared to hold that a contractor who tenders a performance so deficient that it can be remedied only by completely redoing the work for which the contract called has established, as a matter of law, that he has substantially performed his contractual obligation.

Because of defendant's deficient performance, plaintiff is now in a position which requires that she pay for a new roof.

The judgment of the trial court is affirmed.

Review Question 4. Both *O.W. Grun Roofing* and *Jacob & Youngs* purport to apply the substantial performance doctrine. In the Texas roofing case, the contractor lost, while the contractor in the New York pipe case prevailed. Are the two cases consistent with one another or not? Explain.

KCA ELECTRONICS, INC. v. LEGACY ELECTRONICS, INC.

Court of Appeal of California, Fourth Appellate District
2007 Cal. App. Unpub. LEXIS 6107 (Ct. App.)

[Legacy wanted to market a device for increasing computer memory that required a thumbnail-sized component called a "ball grid array (BGA) canopy," a unit that uses solder balls on the bottom to make electric contacts with a circuit board. Legacy sent four purchase orders to KCA, a manufacturer, over a nine-month period, for approximately 59,000 BGA canopies. The purchase orders also provided that all of KCA's products must be warranted "to be free from defects and to perform to the original manufacturer's specifications for fit, form and function." Seller KCA responded with invoices that contained a clause that said "Buyer shall exercise its right of inspection within 30 days of receipt . . . and all goods shall be deemed accepted as to quality unless the Seller receives a written notice of rejection within such 30 day period." Things went bad quickly. The first batch was returned because of sticky tape residue on the canopies. They were cleaned and returned, but were again rejected for being undersized. They were reworked and shipped back in installments. The single biggest order, for 40,000 units, was returned because solder balls on the canopies were smashed and there was exposed copper. KCA inspected them, decided they were fine, and sent back to Legacy. This led to a dispute, and the parties agreed that all units would be tested by Legacy. In testing, it turned out that 6 percent of

the units were defective. After discussions trying to settle the matter, Legacy rejected the goods and refused to proceed. KCA sued.]

In this case we review a judgment in a lawsuit between a commercial seller and a commercial buyer over rejected merchandise. Accordingly, we begin with a quick review of some relevant UCC provisions:

A provision of the Uniform Commercial Code (UCC), § 2-601, (also enacted in California as § 2-601 of the Commercial Code), is known as the perfect tender rule. The operative words of the statute allow a buyer to reject “the whole” of a delivery of goods if the goods “fail in any respect to conform to the contract.” Courts have noted that the perfect tender rule imposes “a very high level of conformity” to the contract on sellers, allowing buyers to “reject a seller’s tender for any trivial defect, whether it be in the quality of the goods, the timing of the performance, or the manner of delivery.” *Midwest Mobile Diagnostic Imaging v. Dynamics Corp.*, 965 F. Supp. 1003, 1011 (W.D. Mich. 1997).

The perfect tender rule is tempered, however, by another UCC provision, § 2-508 which affords sellers a right to cure the nonconformity.

Also, the perfect tender rule does not apply to installment contracts, an exception which embodies a policy of the law to protect longer-term commercial relationships. As one commentator has described the installment contract exception:

The policy in installment contracts is to avoid the abrupt termination of a long term contractual relationship merely for technical reasons and to keep the contract going. Where many deliveries are contemplated, minor defects are likely to appear in some installments and it would give the buyer an unreasonable commercial advantage if he could escape from the contract for the trivial deficiencies which inevitably occur. In an installment contract the buyer has sufficient bargaining power vis-a-vis future shipments to adjust minor defects.”

William H. Lawrence, *Appropriate Standards for a Buyer’s Refusal to Keep Goods Tendered by a Seller*, 35 WM. & MARY L. REV. 1635, 1654 n. 86 (1994).

The installment exception to the perfect tender rule is found in § 2-612 of the UCC. Unlike the perfect tender standard of § 2-601, § 2-612 embodies a “substantial impairment” standard; that is, the buyer may cancel “only when the nonconformity of one or more installments ‘substantially impairs the value of the whole contract.’”

In the present case even the seller recognizes that, at the end of the day, six percent of the parts it shipped were defective, which in the context of parts for computer memory, not only fails to constitute perfect tender, but also represents a substantial impairment of the value of the whole of the shipments. We therefore conclude that under both the “perfect tender” standard and the “substantial

impairment” standard there was substantial evidence to support the trial court’s decision that the seller take nothing by way of its complaint against the buyer.

This case is simple if the perfect tender rule governs. And the trial court impliedly concluded that the perfect tender rule does govern, because it explicitly found that the “pattern” of sales by KCA to Legacy was not an installment contract.

Under the perfect tender rule, two facts are dispositive: (1) There is no question that 6 percent of the sample of some 20,000 parts were nonconforming, and (2) by the time the parties had agreed to test the sample of some 20,000 parts, KCA had the better part of a year to produce 100 percent conforming canopies. That is, KCA never “seasonably” exercised its right to cure, because, by no less than the third order filled by February 2004, Legacy was still receiving defective canopies on a series of orders which started the previous July.

[Turning to the argument that this was an installment contract,] KCA argues that there was no substantial impairment of value given the ultimate 94 percent pass rate of the final (20,160 unit) sample. On this point, however, Legacy must prevail given the standard of review under which this court must operate.

There was testimony from Legacy’s director of manufacturing that every single solder ball “is an electrical contact that needs to make connection” for the module to work. Missing or sheared solder balls will not make contact, and that would mean the whole module would be “basically not functioning” and would have to be “reworked or repaired.” In short, even one defective canopy would mean a computer that didn’t work.

It is a reasonable inference that, had Legacy simply processed all the canopies supplied by KCA, the results would have been commercially unacceptable, particularly given the evidence that the canopies were for a new product, and it would be reasonable for the trial court to conclude that even a six percent failure rate would tarnish the new product’s reputation. It is particularly noteworthy, in that regard, that Legacy discontinued its inspection at 20,000 units because the inspection process itself tied up a production line. That is, the “cost of inspection” was itself significant, because it showed a need for zero tolerance of defective parts as part of the original contract. The trial court could thus reasonably conclude that the six percent failure rate was a substantial impairment of the value of the whole contract.

KCA [also] argues that Legacy waited an unreasonable amount of time to reject the “whole” of the goods covered by the contract. There was, however, substantial evidence on which the trial court could conclude otherwise.

Specifically, earlier shipments had met a series of problems in addition to the “sheared or smeared” solder balls: sticky glue, undersizing, and problems with the silkscreen identification that interfered with the production line. While it is true that KCA may have cured those defects, the very fact of a series of defects (reminiscent of

a car buyer who buys a lemon) meant that the trial court could conclude it was commercially reasonable for Legacy to forebear on rejecting the whole of the inventory until it encountered the defect (the solder-balls) that simply wasn't going to be cured. The real time frame for rejection, then, was not July 2003 to July 2004, but early May 2004 (when the sample showed a six percent failure rate) to the letter in July 2004—barely more than a month.

The judgment is affirmed. Respondent is to recover its costs on appeal.

Review Question 5. The *KCA Electronics* case illustrates the value of the perfect tender rule to a buyer in the position of Legacy Electronics who, you should note, would then turn around and be in the position of a UCC seller with its ultimate products. Yet the court reaches the same result under the substantial impairment standard for installment contracts in section 2-612. Given that the buyer prevailed in *KCA Electronics* under both standards, what situation might you imagine where a seller would be in breach under the perfect tender rule yet not be substantially impaired?

FANOK v. CARVER BOAT CORP.

United States District Court for the Eastern District of New York
576 F. Supp. 2d 404 (E.D.N.Y. 2008)

CONAN, U.S.D.J.

Jeffrey Fanok brings this action against Carver Yacht Corp. [and] Staten Island Yacht Sales, Inc. (“SIYS”) which arises from his 59-foot Marquis yacht catching fire and sinking off the coast of Sandy Hook, New Jersey. Each of the defendants has moved for summary judgment.

On April 22, 2006, plaintiff entered into a purchase agreement with SIYS for a 59-foot Marquis Yacht for the 2005 model year. The purchase price was \$1,376,940, inclusive of six percent tax. It appears that plaintiff, at the time of the incident, had paid \$1,202,940.

Carver inspected the yacht in accordance with its manufacturing and quality control procedures prior to its transfer to SIYS. It passed all inspections. It was then shipped, on October 25, 2004, in parts, to SIYS, where it was assembled. Upon receipt of the yacht, SIYS completed a “Pre-Delivery Service Record,” confirming the proper operating condition and seaworthiness of the yacht. When plaintiff and SIYS signed

the purchase agreement, SIYS agreed to install some after-market features (aft cockpit controls, a flybridge grill, and a video camera) and make certain repairs. The yacht remained located at SIYS' facility, although plaintiff had access to and use of it as he wished. The reverse side of the purchase agreement provided:

DEALER MAKES NO WARRANTIES EXPRESS OR IMPLIED OF, IN ANY YACHT OR ITEM PURCHASED HEREUNDER AND NO WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE ARE INTENDED. WARRANTY, IF ANY, OF ANY ITEM PURCHASED HEREUNDER SHALL BE SOLELY THE WARRANTY GIVEN BY THE MANUFACTURER.

Carver provided a limited express warranty. This document included, among other things, Carver's warranty that the yacht "will be free from defects in material and workmanship for one (1) year from delivery to the original retail owner." It further stated that "for this limited warranty to be valid, Carver must receive a Warranty Registration Form, duly completed and signed by the Owner, within fifteen (15) days of delivery" of the yacht, and that the retail dealer (here, SIYS) is responsible for sending the signed registration form to Carver. Finally, this express warranty excluded all implied warranties, including merchantability and fitness for a particular purpose, and stated that "[y]our acceptance of delivery of the warranted Marquis yacht constitutes your acceptance of the terms of this limited warranty."

While the yacht was at SIYS, plaintiff was permitted, and evidently encouraged, to sail it. Plaintiff requested training on the yacht, so SIYS provided him with a captain who tutored him, onboard, for five to six hours. Plaintiff used the yacht four or five times, for a maximum of fifteen hours, before the incident in question.

Plaintiff never had title to the yacht, nor did he sign Carver's "Warranty Registration," SIYS' "Notice of Owner's Acceptance of Vessel," or SIYS' "Customer Warranty Acknowledgment." The yacht was never registered. He did sign SIYS' "Purchase Agreement," which, as noted above, had SIYS' warranty exclusion in it.

On July 15, 2006, plaintiff, with his wife Susan, his teenage son, Jeff, one of Jeff's friends, and their two dogs, left SIYS' facility around 11:00 a.m. The group arrived at Horseshoe Cove a short time later, where they intended to have lunch and swim. At the point of anchorage, the water depth was approximately ten to fourteen feet and the yacht's draft (the distance between the water's surface and the bottom of the yacht) was five feet.

When the time came to move from their spot, plaintiff put the engine to idling speed to ensure that the propellers were not rotating. His son, Jeff, used a yacht hook to position the anchor into the bow, but lost his grip on the hook and dropped it into the water. As the others on the yacht went to retrieve it, the yacht began to drift. By the time they returned to the cockpit, the yacht had come into contact with a sandbar, causing the bow to swing around. Plaintiff stated that he cut off the engines and engaged both the stern and bow thrusters. At least a minute later, plaintiff's wife and

the children smelled something burning and saw smoke rising out of the port engine vent. At that point, plaintiff entered the main salon and shut down the electrical system and generator.

Returning to the controls, plaintiff called the Coast Guard for help. In the meantime, he directed everyone on board to put on life jackets and gather on the stern platform. Plaintiff's wife scoured the yacht in search of one of the dogs, which was missing. As the floors were beginning to melt, the family was taken from their yacht by another vessel.

Within ten minutes of their departure from the yacht, it became engulfed in flames. Less than a half hour after the initial call, the Coast Guard arrived and worked to put out the fire. Its efforts were to no avail, and the yacht burned down to the waterline. After two hours and 42 minutes, the fire was extinguished, at which point the skeleton of the yacht drifted into a rock pile and grounded. It was estimated that 20 gallons of fuel remained on board, indicating that approximately 380 gallons burned in the fire.

[Plaintiff—or, rather, the insurance company pursuing the case—advanced several claims that the yacht was defective, but failed to prove them.]

As an alternative to showing the existence of a triable issue as to whether there was a defect in the yacht, plaintiff contends that he does not have to show a defect because, in fact, Carver and SIYS never “delivered” the yacht. Plaintiff's implication is that by not delivering the yacht, Carver and SIYS breached the contract. According to plaintiff, this failure to deliver is due to the fact that there was a punch list of items remaining to be performed by SIYS, and thus any purported delivery did not comply with the “perfect tender” rule.

As to SIYS, although plaintiff never signed its “Notice of Owner's Acceptance of Vessel” form or entered into a rental agreement for a slip at SIYS, that was not required to effect delivery of the yacht under the UCC. Section 2-308 states that “unless otherwise agreed, the place for delivery of goods is the seller's place of business.”⁵ Plaintiff thus did not have to bring in a trailer and take the yacht away to affect a delivery. The facts are undisputed that once he signed the contract, paid the bulk of the purchase price and gave a promissory note for the rest, he asserted dominion and control of it, taking it out when he wanted, as he did on the day of the fire. He held himself out as the owner of the yacht, buying insurance on it, putting in an insurance claim for its loss (and accepting payment), and obtaining a Certificate of Documentation in his name from the Coast Guard.

⁵ [Section 2-308 is one of those UCC gap-filler terms of the sort we discussed in the Terms and Interpretation materials for the course. Where the parties to a sale-of-goods contract do not include a term specifying a place of delivery, the code provides one for them—at least to some extent. – Eds.]

Plaintiff's reliance on the "perfect tender" rule to avoid the conclusion of delivery is misplaced. That rule provides a framework to determine whether a buyer's rejection of goods is proper. When a seller makes an imperfect tender, nothing happens by mere operation of law; should the buyer not reject within a reasonable time, he waives his right to challenge the alleged imperfection. Instead of an imperfect tender invalidating a transaction after material changes in the parties' positions have occurred, as plaintiff is attempting to do here, the perfect tender rule gives the buyer a provisional right to reject the goods "within a reasonable time after delivery or tender." UCC § 2-602(1).

However, plaintiff does not contend that he rejected the yacht on the "punch list grounds" until after the yacht burned. The punch list items to which plaintiff refers—comprised mostly of items like "scratches on kitchen table;" "clean inside carpeting"; and "are the master bath shower doors supposed to rattle a lot when underway?"—were never items that caused plaintiff to reject or even to threaten to reject the yacht. It is only now that the yacht is destroyed that plaintiff seizes upon them as an indication of non-delivery. The equipment additions that the contract included fall into that same category. They did not impact on the delivery of the yacht to plaintiff.

Indeed, the majority of items on the punch list were sufficiently minor that even under the perfect tender rule, they may not have supported rejection as opposed to an adjustment of the purchase price, as such an attempted rejection might be indicative of bad faith. *See* UCC § 1-203 [now UCC § 1-304]; *T.W. Oil, Inc. v. Consol. Edison Co. of New York, Inc.*, 443 N.E.2d 932 (N.Y. 1982) ("In contrast [to the perfect tender rule], to meet the realities of the more impersonal business world of our day, the code, to avoid sharp dealing, expressly provides for the liberal construction of its remedial provisions (§ 1-102) so that 'good faith' and the 'observance of reasonable commercial standards of fair dealing' be the rule rather than the exception in trade."). The punch list items certainly would not have supported rejection without a reasonable opportunity for SIYS to cure them. *See* UCC § 2-106 cmt 2 ("the seller is in part safeguarded against surprise as a result of sudden technicality on the buyer's part by the provisions of § 2-508 on seller's cure of improper tender or delivery").

In the absence of any evidence that plaintiff ever rejected the yacht, plaintiff's alternative position is that he never "accepted" delivery. Again, however, the UCC requires a contrary conclusion. Section 2-606 specifies three methods of acceptance. Plaintiff's position—that he could only accept by signing the relevant acceptance forms or advising SIYS expressly that he was accepting—would fall under § 2-606(1)(a) (acceptance occurs when the buyer "signifies that the goods are conforming or that he will retain them in spite of their non-conformity"). Section 2-606(1)(b), however, provides that acceptance occurs when, after a reasonable time for inspection, the buyer "fails to make an effective rejection." In addition, § 2-606(1)(c)

provides the further alternative of deeming acceptance made if the buyer “does any act inconsistent with the seller’s ownership.” Both subsections (1)(b) and (1)(c) show an acceptance here.

Plaintiff used the yacht for nearly three months before the day of the fire. Yet as noted above, at no time did plaintiff reject the yacht as non-conforming. Having failed to give any indication of rejection until after the fire, plaintiff accepted the yacht under § 2-606(1)(b). *See Ask Technologies, Inc. v. Cablescope, Inc.*, No. 01 Civ. 1838, 2003 U.S. Dist. LEXIS 18694, 2003 WL 22400201 (S.D.N.Y. Oct. 20, 2003) (where buyer complained, complaints were resolved, and buyer continued to use products for months after complaining, acceptance occurred); *EPN-Delaval, S.A. v. Inter-Equip, Inc.*, 542 F. Supp. 238 (S.D. Tex.1982) (where buyer stored but did not use goods prior to inspection and rejection, acceptance occurred under § 2-606(1)(b) since he did not inspect and discover defect within reasonable time).

In addition, plaintiff engaged in a number of acts inconsistent with ownership in SIYS. Indeed, even in the pleadings and his deposition in this action, plaintiff has repeatedly described himself as the owner of the yacht. No reasonable jury could find that these actions, singly and collectively, are insufficient to constitute an acceptance under § 2-606(1)(c).

Defendants’ motions for summary judgment are granted. The Clerk is directed to enter judgment in favor of defendants, dismissing the complaint.

Review Question 6. The *Fanok* court states that most of the defects identified by the buyers (on the “punch list”) before launching their new yacht “were sufficiently minor that even under the perfect tender rule, they may not have supported rejection as opposed to an adjustment of the purchase price, as such an attempted rejection might be indicative of bad faith.” What does the court mean by that statement and what does it tell you about the limits of the perfect tender rule?

Review Question 7. Carefully read UCC section 2-606 (“What Constitutes Acceptance of Goods”). Be prepared to explain exactly what Mr. Fanok did in this case that counted as an “acceptance” of the yacht. By the way, beware of confusing terminology here: the “acceptance” of goods in a sale has nothing to do with “acceptance” of an offer to form a contract in the first place. In *Fanok*, for instance, there was no dispute between the parties as to whether a contract existed between them; it clearly did, and the parties were arguing over performance and breach.

Problems

Problem 21.1

Actor is a very socially conscious individual and is particularly passionate about the importance of labor unions. He hires Architect to develop plans for his new 40,000-square-foot hillside home in Malibu. The contract specifically provides that all the materials listed in Annex A to the contract be obtained from unionized firms, and prohibits use of non-union materials in any situation where union-made materials exist. One of the categories listed on Annex A is “structural steel.” The requirement for union-made products is clear from the contract, although the reason for the specification is not mentioned. Contractor obtains the contract to build the house. As it is time for the foundation to be laid, however, the only unionized steel supplier notifies Contractor that, while it could eventually provide the steel, the earliest it could do so is three months after Contractor had scheduled the work on Actor’s home. Contractor therefore purchases structural steel for the foundation from Rogue Steel Corp., a non-union manufacturer famous for its hard-line battles against union organizers, which include three separate cases before the U.S. Supreme Court. The steel beams acquired from Rogue are embedded in the foundation and work continues.

When the home is virtually finished, a Hollywood gossip sheet reports that the home of Actor, the famous union activist, actually is built on a foundation of Rogue Steel. Actor is appalled. All his pleasure in the home is destroyed. Evidence shows that the steel cannot be replaced except by effectively demolishing the entire structure and starting over. Actor demands that Contractor demolish everything down to the foundation and start again. Contractor refuses. Evidence shows that the steel used actually exceeds all contract requirements, except that it is not union-made. It further shows that there is no difference in the value of the home due to the steel. Actor refuses to pay for the home. Contractor sues. What will each side argue, and who do you think has the stronger argument?

Problem 21.2

Major State University, whose highly profitable athletic programs are known as the Shorthorns™, has developed a book about the long and occasionally storied history of its athletic program, entitled *Horns of Excellence*. It contracts with Acme Publishing Co. to produce the book. The contract specifies that Acme will produce 400,000 copies of the book, which MSU plans to sell to alumni and friends. The books will be delivered in four lots of 100,000 each. The detailed contract specifications provide that the book’s cover, which features a picture of one of its semi-legendary coaches, will be produced in Shorthorn Orange™, a kind of muddy brownish color

that is the official trademarked color of the Shorthorns and is used for all uniforms, goods, and merchandise.

When the first 100,000 copies are delivered to MSU, the school is shocked to discover that the covers have been printed in Volunteer Orange™, a much brighter color that is the trademarked color of a rival university. MSU rejects the first 100,000 volumes. Acme says that it can change the color for the next shipments. MSU, furious, cancels the contract anyway and refuses to pay anything for the books. Acme sues. Evidence shows that not more than five out of 100 Shorthorn fans can actually tell the difference between the two colors. Was MSU's rejection proper? Does it owe anything to Acme if Acme sues for nonpayment?

Problem 21.3

Leigh is a lawyer who has just been elected to the partnership of a large international law firm, where she expects to make a great deal of money over the next several years. To celebrate, she goes to Rich Motors, a trendy downtown Jaguar automobile dealer. "After checking out all of the options, she orders the car of her dreams, a brand-new Jaguar F-type V8S, in British racing green, with a black convertible top, 20" blade wheels, leather performance seats, Meridian surround-sound system, camel carpets, heated sport leather steering wheel, heated windshield, wind deflector, and alloy spare wheel. The parties agree on a price of \$125,500, with delivery to be made on June 1. Leigh puts down a \$12,250 deposit. On June 1, Leigh calls Rich to ask about the car. She is told it has been delayed for a few days. Rich calls a few days later to say that it will be delivered on June 8. Leigh goes down to Rich Motors to take possession. As she looks over the car, she sees an eight-inch scratch in the middle of the shiny green hood. The scratch goes down to the metal and is very noticeable. Rich says it will repair the scratch so that "no one can ever tell it was there." Leigh, nevertheless, rejects the car, saying that she wanted a new mint-condition car. She demands her deposit back. Rich refuses. Leigh sues for return of her deposit, arguing that Rich breached the contract. What result and why?

Problem 21.4

Silicon Micro is a manufacturer of microprocessors used in sophisticated electronics devices. Dull Computer is a manufacturer of personal computers. Dull has bought processors from SM for several years. It places an order for 50,000 SM-505 processors for delivery on August 1. SM sends a written confirmation. When the order reaches SM's production facility, however, it turns out that SM has only 25,000 of the SM-505s in stock. But it has plenty of the faster, more powerful (and more expensive) SM-605 processors in stock. So SM ships the 505s it has in stock along with 25,000 of the 605s, assuming that Dull will be willing to accept the faster, more powerful processor for the same price as the 505s. When the shipment reaches Dull on July 28,

however, it turns out that the 605s will *not* work in the specific low-end models Dull wants them for because they will not run the old operating system. Dull accepts all the 505s but rejects all the 605s. SM immediately offers to send a shipment of 505s to fix the problem. This new shipment would arrive in plenty of time for Dull to use them, but Dull—which has in the meantime received a lower price on 505-equivalent processors from Feng Shui Electronics Ltd. of Taiwan, refuses. When SM subsequently sues Dull for improper rejection, what result? Be sure that UCC sections 2-508 and 2-601 figure prominently in your answer.

Unit 22: Excused Performance

PERFORMANCE AND BREACH

Part Two

FOCUS OF THIS UNIT

When Bad Things Happen to Good Contracts. By this point, you should understand that if a party has a duty under a valid contract and fails to perform the contract in a satisfactory manner, the contracting party is liable for breach. But what happens if a party's failure to perform is caused by something totally beyond its control? Suppose, for example, you agree to lease a house for a year to a tenant, and the day before she moves in a tornado destroys the house. Are you liable for breach of your contract with the tenant? On the other hand, is she liable to you for the rent even though the place has been destroyed?

Original Strict-Liability Standard. The common law has struggled with and changed its position on these questions over the years. Originally, contracts were strict-liability undertakings. If a party failed to perform for *any* reason, then he was liable for breach. Thus, in the famous English case of *Paradine v. Jane*, 82 Eng. Rep. 897 (K.B. 1647), a tenant had rented an estate. Subsequently, he was forcibly evicted from the estate by Royalist troops during the English Civil War, who kept him out of possession for nearly two years. The tenant refused to pay rent to the owner because the tenant could not have possession, making the contract worthless to him. The court held, nonetheless, that the tenant was obliged to pay the full rent, and would have had to do so even if the whole place had burned down or been swallowed by the sea. This strict-liability doctrine, however, began to change in the middle of the nineteenth century. By the early part of the twentieth century, two English cases establishing doctrines of excused performance had become highly influential in the United States.

Origin of "Impossibility of Performance" as an Excuse. The first of these two cases was *Taylor v. Caldwell*, 122 Eng. Rep. 309 (1863), in which a concert promoter had hired a venue called the Surrey Gardens for a major *fête*. Unfortunately, the Gardens were totally destroyed by fire shortly before the event was to take place. The promoter sued on the ground that the owners were in breach for failing to provide the venue. Under *Paradine v. Jane*, this argument looked like a winner. Yet the court held for the owners. It relied on some earlier cases that held when a horse died or a ship sank, a contract for the item's sale was automatically canceled because the

subject of the contract no longer existed. The court reasoned that that the existence of the Gardens as a venue was a basic condition under which the contract was formed. Thus, because destruction of the Gardens made it “impossible” to perform, the owners were excused from performance.

Origin of “Frustration of Purpose” as an Excuse. The second case, *Krell v. Henry*, [1903] 2 KB 740, involved the biggest public spectacle of its day, the coronation of King Edward VII in 1902. Krell was the owner of a flat on Pall Mall in London, which was directly on the coronation route and would provide excellent viewing of the festivities. Henry rented the flat from Krell for the dates of June 26-27, 1902, paying an amount greatly in excess of the flat’s ordinary rental rate. The problem was that the new King got sick and the whole event was canceled and rescheduled for August, which meant that Henry did not need the rooms. He refused to pay the bulk of the rental, and Krell sued. Relying on *The Moorcock* (discussed in our previous unit on implied terms) for the proposition that terms could be implied into contracts, and on *Taylor v. Caldwell*, the court held that Henry was excused from performance. A basic assumption of both contracting parties was that the coronation parade would be held; there would have otherwise been no contract. When the parade was canceled, Henry’s entire purpose for entering into the contract was frustrated.

Modern Excuses from Performance. Note the distinction between *Taylor* and *Krell*. In a sense, they are two sides of the same coin. The argument in *Taylor* was that the party *could not* perform—the Surrey Gardens hall was destroyed. The argument in *Krell* was that while the party *could* perform, there was no longer any reason to do so. These two concepts exist today in American contract law as the doctrines of “impracticability of performance”—originally and still sometimes called “impossibility of performance”—and “frustration of purpose.”

As you read the following materials and work through the problems, you may want to consult the fairly extensive set of impracticability and frustration rules found in sections 261 through 272 of the Restatement (Second) of Contracts. The core section on impracticability of performance is section 261, while the core section on frustration of purpose is section 265.

Cases and Materials

KARL WENDT FARM EQUIPMENT CO. v. INT'L HARVESTER CO.

United States Court of Appeals for the Sixth Circuit
931 F.2d 1112 (6th Cir. 1991)

JONES, Circuit Judge

In the fall of 1974, Wendt and International Harvester entered into a “Dealer Sales and Service Agreement” which established Wendt as a dealer of IH goods in the area of Marlette, Michigan. The agreement set forth the required method of sale, provisions for the purchase and servicing of goods, as well as certain dealer operating requirements. The agreement also provided specific provisions for the termination of the contract upon the occurrence of certain specified conditions.

In light of a dramatic recession in the farm equipment market, and substantial losses on the part of IH, IH [in 1985] negotiated an agreement with J.I. Case Co. and Tenneco Inc. to sell its farm equipment division to Case/Tenneco. The sale took the form of a sale of assets. The base purchase price was \$246,700,000 in cash and \$161,300,000 to be paid in participating preferred stock in Tenneco. While IH asserts that it lost \$479,000,000 on the deal, it also noted that this was a “paper loss” which will result in a tax credit offsetting the loss.

In its purchase of IH’s farm equipment division, Case/Tenneco did not acquire IH’s existing franchise network.¹ Rather, it received “access” to IH dealers, many of whom eventually received a Case franchise. However, there were some 400 “conflicted areas” in which both a Case and an IH dealership were located. In these areas Case offered only one franchise contract. In nearly two-thirds of the conflicted areas, the IH dealer received the franchise. However, Marlette, Michigan was such a “conflicted area” and Wendt was not offered a Case franchise.

Wendt filed this action alleging breach of IH’s Dealer Agreement and several other causes of action, but all Wendt’s allegations save the breach of contract action were disposed of before trial. IH filed a counter-claim against Wendt for debts arising out of farm equipment and parts advanced to Wendt on credit.

¹ [If Case and Tenneco had bought the *corporation* that was International Harvester’s farm equipment division, it would have inherited all of IH’s contracts, including that with Wendt. By purchasing only the *assets* of IH’s farm equipment division (i.e., not the entity but simply its real, personal, and intellectual property), Case did not assume any of the contractual liabilities. IH’s sale of its assets did not automatically terminate any of its contractual liabilities, which means that Wendt’s contract remained with IH. That is why IH is the defendant in this lawsuit, as Wendt never had a contract with Case.—Eds.]

At trial, the court allowed IH's defense of impracticability of performance to go to the jury on the contract action. The jury returned a verdict of no cause of action on the contract and the district court denied Wendt's motion for J.N.O.V./new trial, which was based on the invalidity of the impracticability defense. In addition, however, the court ordered a directed verdict for Wendt as to IH's defenses of frustration of purpose.

Wendt asserts a number of errors surrounding the district court's allowing the defense of impracticability of performance to go to the jury. Wendt first contends that the defense of impracticability due to extreme changes in market conditions is not a cognizable defense under Michigan law. In the alternative, Wendt argues that there was insufficient evidence to withstand Wendt's motion for a directed verdict on impracticability.

Wendt first contends that impracticability is only cognizable under Michigan law as a defense to contracts for sale of goods governed by the UCC. For this contention, Wendt cites *Cleveland-Cliffs Iron Co. v. Chicago & Northwestern Trans. Co.*, 581 F. Supp. 1144, 1151 (W.D. Mich. 1984), which suggested that the defenses of frustration of purpose and impracticability were only available as defense to an action under Mich. Comp. Laws Ann. § 440.2615 [Michigan's version of UCC § 2-615], and were not available in situations where a party alleged that the contract had become unprofitable due to a change in market conditions.

The district court found that *Cleveland-Cliffs* incorrectly stated Michigan law. The court asserted that the Michigan Supreme Court's recognition of the doctrine of impossibility [in common law actions before 1964] was not altered by its adoption of the UCC in 1964 and further that the doctrine of impossibility was broadened by the Michigan Court of Appeals in *Bissell v. L.W. Edison Co.*, 156 N.W.2d 623 (Mich. Ct. App. 1967), to excuse future performance when circumstances make performance impracticable. Thus, as the district court put it,

The relevant question is not whether the doctrine of impossibility as defined by the Michigan Supreme Court remains valid. . . . [Rather,] the only issue in dispute is whether the Michigan Supreme Court would adopt the doctrine of impracticability of performance embraced by the Court of Appeals in *Bissell*.

We find that the district court properly framed the question presented here.

Generally, under Michigan law, "economic unprofitableness [sic] is not the equivalent to impossibility of performance. Subsequent events which in the nature of things do not render performance impossible, but only render it more difficult, burdensome, or expensive, will not operate to relieve [a party of its contractual obligations]." *Chase v. Clinton County*, 217 N.W. 565, 567 (Mich. 1928).

In *Bissell*, the Michigan Court of Appeals, relying on [the first] Restatement of Contracts § 457, concluded that the doctrine of impossibility is a valid defense not only when performance is impossible, but also when supervening circumstances make performance impracticable. Section 457, now § 261 of the Restatement (Second) of Contracts (1981) provides:

Discharge by Supervening Impracticability.

Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.

Although *Bissell* did not involve non-performance due to economic causes, the court relied extensively on § 457 which defines impossibility to include, "not only strict impossibility but impracticability because of extreme and unreasonable difficulty, expense, injury and loss involved." *Bissell*, 156 N.W. 2d at 626. In the instant case the district court relied heavily on the language of § 457 quoted in *Bissell* to conclude that the extreme downturn in the market for farm products was "unreasonable and extreme" enough to present a jury question as to the defense under Michigan law.

Recognizing that *Bissell* suggests that an impracticability defense may be cognizable under Michigan law in some circumstances, we must turn to the question of whether under Michigan law, the defense of impracticability was appropriately presented to the jury under the circumstances involving a dramatic downturn in the market for farm equipment which led to the contract action before us in this case. The commentary to § 261 of the Restatement (Second) provides extensive guidance for determining when economic circumstances are sufficient to render performance impracticable. Comment d makes clear that mere lack of profit under the contract is insufficient:

"Impracticability" means more than "impracticality." A mere change in the degree of difficulty or expense due to such causes as increased wages, prices of raw materials or costs of construction, unless well beyond the normal range, does not amount to impracticability since it is this sort of risk that a fixed price contract is intended to cover.

Comment d also provides:

A severe shortage of raw materials or of supplies due to war, embargo, local crop failure, unforeseen shutdown of major sources of supply, or the like, which either causes a marked increase in cost or prevents performance altogether may bring the case within the rule stated in this Section.

More guidance is provided in Comment b:

In order for a supervening event to discharge a duty under this Section, the non-occurrence of that event must have been a “basic assumption” on which both parties made the contract.

Comment b goes on to provide that the application of the “basic assumption” criteria

is also simple enough in the cases of market shifts or the financial inability of one of the parties. The continuation of existing market conditions and of the financial situation of one of the parties are ordinarily not such assumptions, so that mere market shifts or financial inability do not usually effect discharge under the rule stated in this Section.

Comment b also provides two helpful examples. In Illustration 3, A contracts to employ B for two years at a set salary. After one year a government regulation makes A’s business unprofitable and he fires B. A’s duty to employ B is not discharged due to impracticability and A is liable for breach. In Illustration 4, A contracts to sell B a machine to be delivered by a certain date. Due to a suit by a creditor, all of A’s assets are placed in receivership. A is not excused for non-performance under the doctrine of impracticability.

In our view, section 261 requires a finding that impracticability is an inappropriate defense in this case. The fact that IH experienced a dramatic downturn in the farm equipment market and decided to go out of the business does not excuse its unilateral termination of its dealership agreements due to impracticability. IH argues that while mere unprofitability should not excuse performance, the substantial losses and dramatic market shift in the farm equipment market between 1980 and 1985 warrant the special application of the defense in this case. IH cites losses of over \$2,000,000 per day and a drop in the company’s standing on the Fortune 500 list from 27 to 104. IH also put on evidence that if it had not sold its farm equipment division, it might have had to declare bankruptcy. While the facts suggest that IH suffered severely from the downturn in the farm equipment market, neither market shifts nor the financial inability of one of the parties changes the basic assumptions of the contract such that it may be excused under the doctrine of impracticability. Rest. 2d § 261 cmt b. To hold otherwise would not fulfill the likely understanding of the parties as to the apportionment of risk under the contract. The agreement provides in some detail the procedure and conditions for termination. IH may not have been entirely responsible for the economic downturn in the company, but it was responsible for its chosen remedy: to sell its farm equipment assets. An alternative would have been to terminate its Dealer Agreements by mutual assent under the termination provisions of the contract and share the proceeds of the sale of assets to Case/Tenneco with its dealers. Thus, we find that IH had alternatives which

could have precluded unilateral termination of the contract. Further, application of the impracticability defense in this case would allow IH to avoid its liability under franchise agreements, allow Case/Tenneco to pick up only those dealerships it sees fit and leave the remaining dealers bankrupt. In such circumstance, application of the doctrine of impracticability would not only be a misapplication of law, but a windfall for IH at the expense of the dealers.

In the end, IH simply asserts that it would have been unprofitable to terminate its agreements with its dealers by invoking the six-month notice and other termination procedures embodied in the Dealer Agreement, or by sharing the proceeds of its sale of its farm equipment assets with dealers. This assertion does not excuse IH's performance under the agreement.

We hold that while the Supreme Court of Michigan might recognize the defense of impracticability, it would not do so in the circumstances of this case as a matter of law.

In its cross-appeal, IH asserts that the court improperly granted a directed verdict for Wendt on IH's defense of frustration of purpose.

It is undisputed that Michigan law recognizes the defense of frustration of purpose. *See Molnar v. Molnar*, 313 N.W.2d 171, 173 (Mich. Ct. App. 1981) (allowing the defense of frustration of purpose in a suit to discontinue child support payments when the beneficiary child died). However, the district court in the instant case determined that the defense was unavailable. In making this determination, the court relied on § 265 of the Restatement (Second) of Contracts, which provides:

Where, after a contract is made, a party's principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his remaining duties to render performance are discharged, unless the language or the circumstances indicate the contrary.

In interpreting this provision, the district court relied on the Supreme Court of South Dakota's analysis of this same defense when raised by IH in a suit by a dealer for breach of the same dealer agreement in *Groseth International v. Tenneco*, 410 N.W.2d 159 (S.D. 1987).

In *Groseth*, the court found that under the Restatement (Second), the defense of frustration requires the establishment of three factors. The first is that the purpose frustrated by the supervening event must have been the "principal purpose" of the party making the contract. Quoting § 265, comment a, the court noted,

It is not enough that [the contracting party] had in mind a specific object without which he would not have made the contract. The object must be

so completely the basis of the contract that, as both parties understand, without it the transaction would make little sense.

The court interpreted this passage to require an inquiry into the principal purpose of the contract and a finding that the frustrating event destroys the primary basis of the contract.

According to the *Groseth* court, the second factor required under the Restatement is that the frustration be “substantial.” Once again quoting comment a to section 265, the court stated:

It is not enough that the transaction has become less profitable for the affected party or even that he will sustain a loss. The frustration must be so severe that it is not fairly to be regarded as within the risks that he assumed under the contract.

The court added, “the fact that performance has become economically burdensome or unattractive is not sufficient to excuse performance.”

Finally, according to *Groseth*, the third factor required to make out a defense of frustration under the Restatement is that the frustrating event must have been a “basic assumption” of the contract. In analyzing this element, comment a states that the analysis is the same as under the defense of impracticability.

Applying these three factors in the instant case, the district court found that the primary purpose of the Dealer Agreement was stated in section 1 of the agreement. Section 1 provides,

The general purposes of the agreement are to establish the dealer of goods covered by this agreement, and to govern the relations between the dealer and the company in promoting the sale of those goods and their purchase and sale by the dealer, and in providing warranty and other service for their users.

The court interpreted this language to mean that the primary purpose of the agreement was to establish the dealership and the terms of interaction and was not “mutual profitability” as asserted by IH. Therefore, the court reasoned that a dramatic down-turn in the farm equipment market resulting in reduced profitability did not frustrate the primary purpose of the agreement. The court went on to suggest that continuity of market conditions or the financial situation of the parties were not basic assumptions or implied conditions to the enforcement of a contract. Thus, following *Groseth*, it held that the doctrine of frustration was not applicable to this case.

IH does not offer any arguments which challenge the correctness of the *Groseth* decision or the district court’s analysis. Rather, IH challenges the court’s finding that the primary purpose of the contract was not “mutual profitability.” In our view, the

district court had substantial grounds for so finding and we affirm the district court's grant of a directed verdict for Wendt on the frustration defense. If IH's argument were to be accepted, the "primary purpose" analysis under the Restatement would essentially be meaningless as "mutual profitability" would be implied as the primary purpose of every contract. Rather, like the doctrine of impracticability, the doctrine of frustration is an equitable doctrine which is meant to fairly apportion risks between the parties in light of unforeseen circumstances. It is essentially an implied term which is meant to apportion risk as the parties would have had the necessity occurred to them. *See Groseth*, 410 N.W. 2d at 166. In this case, the frustrating event was IH's decision to sell its farm equipment assets and go out of that line of business. While IH might have determined that such a move was economically required, it may not then assert that its obligation under existing agreements are discharged in light of its decision.

As the district court erred in allowing the defense of impracticability of performance to go to the jury in this case under Michigan law, we REVERSE and REMAND for a new trial only on the question of damages for IH's breach of its Dealer Agreement with Wendt. With respect to all other assignments of error by the parties, we AFFIRM.

RYAN, J., dissenting.

The court has held that the district court erred in submitting the defendants' defense of impracticability of performance to the jury. I disagree.

The court concedes, correctly I think, that the Michigan Supreme Court "might" recognize the impracticability doctrine, but the court says, "it would not do so in the circumstances of this case as a matter of law." Despite the court's use of the verb "might," I assume it means the Michigan Supreme Court, in all probability, "would," if asked, adopt the doctrine of impracticability of performance as defined in Restatement (Second) of Contracts § 261. In declaring that the Michigan Supreme Court would not apply the doctrine "in the circumstances of this case," I take the court to mean the "facts" of this case. The court cannot mean that the impracticability doctrine can never be applied in a case involving unforeseeable, extreme, and unreasonable economic circumstances. There is simply no authority to be found in the Michigan cases, or indeed in the commentary to § 261, to suggest that no change in economic circumstances, no matter how catastrophic, would ever be sufficient to invoke the impracticability defense. Indeed, the majority opinion observes that the commentary to § 261 "provides extensive guidance for determining when economic circumstances are sufficient to render performance impracticable."

It appears that the majority opinion rejects the impracticability defense "in the circumstances of this case" because, in the court's view, the economic reverses confronted by IH were not so "extreme and unreasonable," severe, or catastrophic as to excuse performance of the franchise agreement with the plaintiffs. Although claiming to recognize that whether impracticability of performance has been proved

is a question of fact for the jury, *Michigan Bean Co. v. Senn*, 287 N.W.2d 257 (Mich. 1979), the court appears to disagree with the jury that IH was confronted with economic circumstances sufficiently disastrous to justify discharge for impracticability. There were “alternatives,” the court says, “which might have precluded unilateral termination of the contract.”

Whether the “alternative” the court suggests ever occurred to IH’s management, or, if considered, was a feasible business solution, is entirely irrelevant on this appeal because it is the jury, not this court, that is empowered to determine whether IH proved impracticability of performance as that defense was defined by the trial court.

Since there is nothing in the jurisprudence of the impracticability defense to suggest that a market collapse of the kind shown by IH is not, as a matter of law, within the doctrine, we are not free to disturb the jury’s verdict.

Review Question 1. “Impracticability” seems to mean something more than the prospect of losing lots and lots of money and going bankrupt as a result, but it also seems to mean something less than performance of a contract being literally impossible. What exactly is impracticability? What sort of additional facts can you imagine where, if International Harvester had proven them, it could have reached the jury in impracticability?

Review Question 2. The excuse of “frustration of purpose requires proof of “the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made.” At the time of its 1974 dealership agreement with Karl Wendt Farm Equipment, International Harvester surely assumed that it would maintain the farm equipment division it sold in 1985. Why, then, does International Harvester not succeed in proving frustration of purpose?

BUSH v. PROTRAVEL INTERNATIONAL, INC.

Civil Court of the City of New York
192 Misc. 2d 743, 746 N.Y.S.2d 790 (Civ. Ct. 2002)

VITALIANO, J.

Dreams of a honeymoon safari in East Africa dashed offer fresh evidence of how the terror attack on the World Trade Center of September 11, 2001 has shredded the lives of ordinary New Yorkers and has engendered still continuing reverberations in decisional law. What might have ordinarily warranted summary disposition in

favor of the safari company and its travel agent, pinning on the traveler the economic burden of trip cancellation, cannot, in the wake of September 11th, be sustained here on their motion for summary judgment.

Defendant Taicoa Corporation, doing business as Micato Safaris, acknowledges that plaintiff Alexandra Bush contacted Micato about booking a safari. By its admission, Micato referred the plaintiff to defendant ProTravel International, Inc., a retail travel agent, to arrange for a reservation on one of the various safaris offered by Micato. It is undisputed that, on or about May 8, 2001, the plaintiff booked an African safari travel package for herself and her fiancé through ProTravel with Micato. At that time, it is also undisputed, the plaintiff gave ProTravel an initial 20% deposit in the amount of \$1,516. Micato admits that it received the plaintiff's deposit from ProTravel on May 15, 2001. The safari Alexandra Bush selected for husband to be and herself was scheduled to begin on November 14, 2001.

Sixty-four days before the safari's start, September 11, 2001, the world, as we knew it, came to an end. As a result of the attack on the World Trade Center, other terrorism alerts and airline scares, the plaintiff and her fiancé decided almost immediately to cancel their trip. Further, the plaintiff claims, she endeavored to notify ProTravel of her decision, but, as a result of the interruption of telephone service between Staten Island, where she had fled to safety, and Manhattan, where ProTravel maintained an office in midtown, she was physically unable to communicate her cancellation order until September 27, 2001. ProTravel agrees that the plaintiff did contact it that day and avers it passed along her request to Micato orally and in writing. Micato acknowledged receiving a fax from ProTravel to that effect on October 4, 2001. Thereafter, when the defendants refused to return her deposit, Alexandra Bush sued in this action to get it back.

The defendants, by their Manhattan and Massachusetts counsel, now move for summary judgment dismissing this action.

The defendants' motion hangs on a registration form. A copy of a completed form executed by Alexandra Bush was annexed to the moving affidavits of Joseph Traversa and Patricia Buffolano. Mr. Traversa, the employee of ProTravel who made the plaintiff's travel arrangements, states that the plaintiff completed and signed the form when she booked the safari on May 8, 2001. The form contained the following provision: "I confirm that I have read and agree to the Terms and Conditions as outlined in our brochure." Also annexed to the moving affidavits was an excerpt the defendants contend was in the "brochure" referenced in the registration form, and which the plaintiff claims she never received, setting forth Micato's cancellation policy for the safari booked by Ms. Bush. The policy imposes a \$50 per person penalty for a cancellation occurring more than 60 days prior to departure. For a cancellation occurring between 30 and 60 days prior to departure, the traveler was subject to a penalty equal to 20% of the total retail tour rate. There is no disagreement that the deposit given by the plaintiff was in an amount equal to 20% of the tour rate.

With a departure date of November 14, 2001, for Alexandra Bush the days of moment under the cancellation policy were September 14, 2001 and October 15, 2001. A cancellation order given by her on or before September 14, 2001, the 61st day prior to departure, would have subjected her to, at worst, a \$50 per person, *i.e.*, a \$100 penalty. Any cancellation after that date but on or before October 15, 2001 would subject her to the greater 20% penalty under the cancellation policy. Using either the September 27, 2001 date Mr. Traversa admits ProTravel received Ms. Bush's notice of cancellation or the October 4, 2001 date Micato's general manager, Patricia Buffolano, claims in her affidavit that Micato received written confirmation of the cancellation from ProTravel, the plaintiff's trip cancellation came within the 30- to 60-day prior to departure window that would trigger a 20% penalty for cancellation. On the strength of those facts, neither defendant returned the deposit to Alexandra Bush and both now seek summary judgment dismissing her claim.

Without conceding that the cancellation policy the defendants advance as their sword and buckler is either valid or binding on her, Ms. Bush states in her affidavit submitted in opposition to the motion that, beginning on September 12, 2001 and continuing for days thereafter, she attempted to contact the travel agency and that due to difficulties with telephone lines, access to Manhattan and closures of its office, she was unable to speak to someone from ProTravel until September 27, 2001. All of the phone calls made by the plaintiff to ProTravel were placed from Staten Island. While ProTravel's reply affidavit protests that it was open for business from September 12th and onward and supplies phone records to show its phones were able to make and receive calls, no evidence is offered to dispute the plaintiff's claim that it was virtually impossible for many days after the terrorist attack to place a call from Staten Island if such call was transmitted via the telephone trunk lines in downtown Manhattan.

In any event, the defendants ultimately argue that all of the horror, heartbreak and hurdles for communications and commerce visited on Alexandra Bush and all New Yorkers in the aftermath of September 11th doesn't matter, for the thrust of their motion is that a contract is a contract, and that since the cancellation call was received, at best, 13 days late, the plaintiff is not entitled, as a matter of law, to her refund. In an equitable bolster to its position, the defendants also assert that Micato imposes the cancellation penalties to cover costs which it incurs in planning and preparing for a customer's safari. However, upon oral argument, defendants were unable to set forth what, if any, expenses had been incurred towards plaintiff's trip, nor when such expenses were incurred. Thereafter, the defendants submitted, in an untimely manner, the further affidavit of Patricia Buffolano, dated June 7, 2002, restating the contention that, prior to receiving notice that Ms. Bush wished to cancel her trip, Micato was required to pay certain expenses. The affidavit, nonetheless, is silent as to when these expenses, and more specifically, whether any such expenses were incurred on or before September 14, 2001, whether any were incurred between

September 14 and September 27, 2001 or whether any were incurred during the one-week delay between the time ProTravel received notification of the cancellation, September 27, 2001, and when Micato claims it received notification from ProTravel, October 4, 2001.

When the residue has been poured away, the issue distilled here is whether the attack on the World Trade Center and the civil upset of its aftermath in the days that immediately followed excuses Alexandra Bush's admittedly late notice of cancellation. More to the point, given that effective cancellation on or before September 14, 2001 would have absolved the plaintiff of the 20% cancellation penalty, does Ms. Bush's sworn statement that she attempted to phone her cancellation notice to ProTravel beginning on September 12, 2001 but did not get through until September 27, 2001 raise a triable issue of fact, which, if resolved in her favor, entitles her to relief from the cancellation penalty provision of the contract?

It is in this context that the motion for summary judgment brought on by the defendants must be considered and it is in this context that they, as the moving parties, must demonstrate that there is no genuine issue of material fact and that they are entitled to judgment as a matter of law. Since summary judgment deprives the litigant of her day in court and is considered to be a drastic remedy, it should not be granted where there is any doubt as to the existence of a material and triable issue of fact.

Though it is true that the black letter of the law establishes the rule that "once a party to a contract has made a promise, that party must perform or respond in damages for its failure, even when unforeseen circumstances make performance burdensome," *Kel Kim Corp. v. Central Markets, Inc.*, 519 N.E.2d 295, 296 (N.Y. 1987), the rule is not an absolute. Where the "means of performance" have been nullified, making "performance objectively impossible," a party's performance under a contract will be excused. *Id.* at 902.

Counsel for the defendants at oral argument claimed to understand the difficulties encountered by literally every New Yorker in the wake of the disaster at the World Trade Center, but argue that those difficulties do not constitute a valid excuse for the failure of the plaintiff to cancel the safari before September 15, 2001. The delay until September 27, 2001, they contend, is inexcusable. Putting aside the sheer insensitivity of their argument, the argument fails to come to grips with Alexandra Bush's sworn claim that the disaster in lower Manhattan, which was unforeseen, unforeseeable and, certainly, beyond her control, had effectively destroyed her ability and means to communicate a timely cancellation under the contract for safari travel she had booked through and with the defendants. To the point, Alexandra Bush claims she could not physically take the steps necessary to cancel on time. Micato and ProTravel, to the contrary, claim she was simply a traveler too skittish to travel after September 11th, who wanted to stick the travel professionals she had retained with the bill for her faint heart. Should the defendants

establish that to be the case to the satisfaction of the jury or at a bench trial, they will be entitled to judgment. They certainly have not established that as a matter of law now.

Furthermore, the plaintiff's claim of excuse because of the frustration of the means of performance is supported, underscored and punctuated by the official actions taken by civil authorities on September 11, 2001 and in the days that followed. On the day of the attack, a state of emergency had been declared by the Mayor of the City of New York, directing the New York City Commissioners of Police, Fire and Health and the Director of Emergency Management to "take whatever steps are necessary to preserve the public safety and to render all required and available assistance to protect the security, well-being and health of the residents of the City." N.Y. City Legis. Ann. at 355.² Simultaneously, the Governor of the State of New York declared a state disaster emergency, directing state officials to "take all appropriate

² The full text of Mayor Rudolph W. Giuliani's proclamation of a state of emergency is as follows:

PROCLAMATION OF A STATE OF EMERGENCY

Date: September 11, 2001

§ 1. Pursuant to the powers vested in me by Executive Law § 24, I hereby declare a State of Emergency.

§ 2. This State of Emergency has been declared because of terrorist attacks on the World Trade Center causing a great many deaths, injuries and extensive damage to buildings and infrastructure in Lower Manhattan. These conditions imperil the public safety.

§ 3. During the State of Emergency, the following orders shall be in effect:

a. All pedestrian and vehicular traffic, except essential emergency vehicles and personnel, shall be prohibited in the following areas: Manhattan-South of 14th Street.

b. The occupancy and use of buildings in the following areas is prohibited: Manhattan-Below 14th Street, except for emergency or essential personnel who have been authorized by the Police Commissioner, Fire Commissioner or the Director of Emergency Management.

§ 4. I hereby direct the Police, Fire and Health Commissioners and the Director of Emergency Management to take whatever steps are necessary to preserve the public safety and to render all required and available assistance to protect the security, well-being and health of the residents of the City.

§ 5. Any person who knowingly violates any provision of this Order is guilty of a class B misdemeanor.

§ 6. This Order shall take effect immediately. It shall remain in effect for 5 days unless it is terminated at an earlier date.

Rudolph W. Giuliani

Mayor

The proclamation by the Mayor was extended seasonably thereafter with no change in any of the declarations relevant to this action.

actions to . . . provide . . . assistance as necessary to protect the public health and safety.” Executive Order [Pataki] No. 113, 9 N.Y.C.R.R. 5.113 (2001).³

Particularly on the days at the focal point of the argument here, September 12, 13 and 14, 2001, New York City was in the state of virtual lockdown with travel either forbidden altogether or severely restricted. Precedent is plentiful that contract performance is excused when unforeseeable government action makes such

³ The full text of Governor George E. Pataki’s Executive Order No. 113 declaring a state disaster emergency is as follows:

No. 113

EXECUTIVE ORDER

Declaring a Disaster Emergency in the State of New York

WHEREAS, unspeakable atrocities have occurred today in New York City, our nation’s capital and Pennsylvania that have taken the lives and injured unknown numbers of innocent people and have caused calamitous and pervasive damage to property; and

WHEREAS, these events appear to be deliberate and coordinated acts of terrorism committed by despicable and cowardly persons or groups unknown;

NOW, THEREFORE, I GEORGE E. PATAKI, Governor of the State of New York, do hereby find that a disaster has occurred for which the affected local governments are unable to respond adequately. Therefore, pursuant to the authority vested in me by the Constitution and the Laws of the State of New York, including Section 28 of Article 2-B of the Executive Law, I hereby declare a State Disaster Emergency effective September 11, 2001 within the territorial boundaries of the State of New York;

FURTHER, pursuant to Section 29 of Article 2-B of the Executive Law, I direct the implementation of the State Disaster Preparedness Plan and authorize, effective September 11, 2001 and continuing, the State Emergency Management Office, the Department of Transportation, the New York State Thruway Authority, the State Police, the Division of Military and Naval Affairs, the Department of Environmental Conservation, the Department of Health, the Office of Mental Health, the State Department of Correctional Services, the Public Service Commission, the Office of Fire Prevention and Control, the Department of Labor, the Office of Parks, Recreation and Historic Preservation and all other State agencies and authorities over which I exercise Executive authority to take all appropriate actions to assist in every way all persons killed or injured and their families, and protect state property and to assist those affected local governments and individuals in responding to and recovering from this disaster, and to provide such other assistance as necessary to protect the public health and safety; and

FURTHER, I have designated Edward F. Jacoby, Jr., Director of the State Emergency Management Office (SEMO) as the State Coordinating Officer for this disaster.

GIVEN under my hand and the Privy Seal of the State in the City of Albany this day eleventh of September in the year two thousand one.

BY THE GOVERNOR

George E. Pataki

Bradford J. Race, Jr.

Secretary to the Governor

performance objectively impossible. *See A&S Transp. Co. v. County of Nassau*, 546 N.Y.S.2d 109 (Sup. Ct. App. Div. 1989); *Metpath, Inc. v. Birmingham Fire Insurance Co.*, 449 N.Y.S.2d 986 (Sup. Ct. App. Div. 1982). Further, in the painful recognition of the obvious and extraordinary dimensions of the disaster that prevented the transaction of even the most time sensitive business during the days and weeks that followed the September 11th atrocities, the Governor even issued an executive order extending the statute of limitations for all civil actions in every court of our state for a period well beyond the times Alexandra Bush claims to have communicated her cancellation and Micato acknowledges it received it. Executive Order [Pataki] No. 113.7, 9 N.Y.C.R.R. 5.113.7 (2001).⁴ In such light, to even hint that Alexandra Bush has failed to raise a triable issue of fact by her argument that the doctrine of impossibility excuses her late cancellation of the safari she booked through ProTravel with Micato borders on the frivolous.

It is not hyperbole to suggest that on September 11, 2001, and the days that immediately followed, the City of New York was on a wartime footing, dealing with wartime conditions. The continental United States had seen nothing like it since the Civil War and, inflicted by a foreign foe, not since the War of 1812. Accordingly, it is entirely appropriate for this court to consider and follow wartime precedents which developed the law of temporary impossibility. Stated succinctly, where a supervening act creates a temporary impossibility, particularly of brief duration, the impossibility may be viewed as merely excusing performance until it subsequently becomes possible to perform rather than excusing performance altogether. *See generally*

⁴ The Governor's Executive Order [provides] as follows:

I hereby temporarily suspend, from the date the disaster emergency was declared . . . until further notice, the following laws:

Section 201 of the Civil Practice Law and Rules, so far as it bars actions whose limitation period concludes during the period commencing from the date that the disaster emergency was declared pursuant to Executive Order Number 113, issued on September 11, 2001, until further notice, and so far as it limits a courts authority to extend such time, whether or not the time to commence such an action is specified in Article 2 of the Civil Practice Law and Rules;

Section 5513 of the Civil Practice Law and Rules, so far as it relates to a limitation period that concludes during the period commencing from the date that the disaster emergency was declared pursuant to Executive Order Number 113, issued on September 11, 2001;

. . .

In addition, I hereby temporarily suspend and modify, for the period from the date of this Executive Order until further notice, any other statute, local law, ordinance, order, rule or regulation or part thereof, establishing limitations of time for the filing or service of any legal action, notice or other process or proceeding . . .

By his amended order of October 4, 2001, the Governor extended the suspension of the statutes of limitation through October 12, 2001, giving yet additional factual support to the disaster conditions still obtaining in New York City at that time.

Annotation, *Modern Status of the Rules Regarding Impossibility of Performance in Action for Breach of Contract*, 84 A.L.R.2d 12, § 14 [a].

The law of temporary and/or partial impossibility flows from the theory that when a promisor has obligated himself to perform certain acts, which, when taken together are impossible, the promisor should not be excused from being “called upon to perform insofar as he is able to do so.” *Miller v. Vanderlip*, 33 N.E.2d 51 (N.Y. 1941). The First Department’s opinion in the World War I era case of *Erdreich v. Zimmermann*, 179 N.Y.S. 829 (Sup. Ct. App. Div. 1920) is extremely instructive. In *Edreich*, the plaintiff purchased German war bonds, which, at the time of purchase on December 14, 1916, was entirely lawful since the United States had not yet entered the conflict. Because of the war, however, the bonds could not be delivered due to a naval blockade. In April 1917, after a state of war had been declared between the United States and Germany, the plaintiff demanded his money back for the defendant seller’s failure to deliver the bonds. Almost two years later, with the bonds essentially worthless, the plaintiff sued for rescission and return of his purchase payment. Appellate Term held that the delivery of the bonds, though legally contracted for, would have been unlawful under wartime rules and, therefore, the contract should have been rescinded for impossibility. The Appellate Division reversed, holding that “at most, performance of [the] contract was suspended during the existence of hostilities” and the performance, which had been temporarily excused for impossibility during hostilities, was now required. The plaintiff was entitled, therefore, to his worthless bonds, but not the return of his purchase payment. This holding is in harmony with even earlier precedents acknowledging the fog of war and its upset of civil society:

Where performance can be had, without contravening the laws of war, the existence of the contract is not imperiled, and even if performance is impossible, the contract may still, when partly executed, be preserved by ingrafting necessary qualifications upon it, or suspending its impossible provisions [i.e., physical impossibility to cancel timely] If the contract . . . can be saved while the war lasts, it should be.

Mutual Benefit Life Ins. Co. v. Hillyard, 37 N.J.L. 444, 468-469 (1874).

So too here, if Alexandra Bush can establish objective impossibility of performance at trial, she is entitled to, at minimum, a reasonable suspension of her contractual obligation to timely cancel, if not outright excuse of her untimely cancellation.

Clearly, the plaintiff has raised, in any event, sufficient material issues of fact concerning both her inability to cancel by September 15, 2001, the safari she had booked and the reasonableness of her cancellation on September 27, 2001, all as a result of the terrorist attack on the World Trade Center, the damage the attack

caused to communications and transportation in the City of New York and the actions of government in declaring and enforcing a state of emergency in the city and beyond.

Accordingly, the motion of defendants ProTravel and Micato for summary judgment dismissing this action is denied in its entirety.

Review Question 3. Why was impossibility (or impracticability) a viable defense to failure to perform the contract in *Bush v. ProTravel* while the defense failed in *Karl Wendt Farm Equipment*? The amount at stake in the farm equipment case seems to be much more than was at issue in the safari honeymoon case. If the amount of money at stake is not determinative, then what exactly *does* explain the divergent results in the two cases?

Review Question 4. The *Bush* court characterizes the defendants' argument as being "that all of the horror, heartbreak and hurdles for communications and commerce visited on Alexandra Bush and all New Yorkers in the aftermath of September 11th" do not matter because "a contract is a contract." Should events as extreme and unanticipated as those of 9/11 provide an all-purpose contract excuse? Why or why not? Weren't there lots of outstanding contractual obligations involving New Yorkers as of that date? Consider the next case when answering this question.

U.S. BANCORP EQUIPMENT FINANCE, INC. v. AMERIQUEST HOLDINGS LLC

United States District Court for the District of Minnesota
2004 U.S. Dist. LEXIS 24709, 55 U.C.C. Rep. Serv. 2d (Callaghan) 423 (2004)

ANN D. MONTGOMERY, U.S.D.J.

In 1999, Brad Gupta formed Ameriquest Holdings LLC. Gupta and his brother-in-law are the sole shareholders of Ameriquest. In July 2000, Ameriquest purchased a Boeing 737 from Bank of America Leasing and Capital. At the time of purchase, the plane was leased to U.S. Airways under a lease scheduled to expire in April 2003.⁵ In

⁵ [For tax, flexibility, and other reasons, airlines frequently choose not to own their planes, but instead to lease them. Since aircraft manufacturers like Boeing prefer to sell, not lease, their planes, third party lessors like Ameriquest, Bank of America Capital and GATX, buy planes and lease them to airlines. The aircraft buyer/lessor profits from the difference between the lease payments it receives from the airline and its loan payments to the lender who financed the purchase. In this case, it appears that Bank of America and GATX wanted to sell their aircraft before the termination of the U.S. Airways and Continental leases, so that someone else would have to worry about re-leasing the used

order to finance the plane, Ameriquest borrowed \$3,858,000 from Firststar Equipment Finance. The loan terms included quarterly payments during the life of the U.S. Airways lease, followed by a lump-sum “balloon” payment equal to the outstanding balance when the lease expired in April 2003. Ameriquest and Firststar entered into a Secured Loan Agreement which gave Firststar a security interest in the Ameriquest Airplane. The Secured Loan Agreement gave Firststar the right to repossess and sell the airplane in the event of default by Ameriquest. Moreover, the Secured Loan Agreement required Ameriquest to obtain written consent from Firststar before re-releasing the Ameriquest Airplane.

Gupta acknowledged that during negotiations for the Ameriquest Airplane loan, he and Firststar had conversations regarding how Ameriquest would remarket the plane following the expiration of the U.S. Airways lease. However, there was no explicit agreement that Firststar would allow Ameriquest to re-lease the airplane to a foreign operator.

Also in 2000, Gupta formed Ananya Aviation LLC, of which he is the sole owner, in order to buy two MD-82 aircraft (the “Ananya Airplanes”) from GATX Capital Corporation (“GATX”). At the time they were purchased, the Ananya Airplanes were leased to Continental Airlines. The leases were set to expire in September 2002. Again, Firststar provided financing for the Ananya Airplanes. Before the completion of the Ananya Airplanes loan, Gupta exchanged e-mails with Scott McCann, a Firststar loan officer, regarding the prospects for re-releasing the Ananya Airplanes following the expiration of the Continental Airlines lease. In an e-mail to McCann dated November 2, 2000, Gupta indicated that he would attempt to market the Ananya Airplanes to operators around the world. In response, McCann informed Gupta that Firststar only financed equipment used domestically. He did indicate a possibility that Firststar might change its policy by the time the Continental Airlines leases expired. However, Gupta testified he understood at the time the loan closed Firststar’s policy was to finance airplanes used domestically.

Four months following the e-mail exchange, Firststar made two loans to Ananya, one for each of the Ananya Airplanes. On March 22, 2001, the loans closed in the amounts of \$5,610,380.59 and \$5,004,047.26. Similar to the Ameriquest Airplane lease, these loans required quarterly payments and a lump-sum balloon payment following the expiration of the Continental Airlines leases in September 2002. Firststar’s prior approval before a new lease was entered was required by the Secured Loan Agreements entered into for the Ananya Airplanes just as it had been under the Secured Loan Agreement entered into with regard to the Ameriquest Airplane.

aircraft. Transactions such as these are popular in many industries, and they are the subject of Article 2A of the UCC, which you will encounter in the upper-level Sales & Leases class. – Eds.]

Following the closing of the above-described loans, USBEF [*i.e.*, U.S. Bancorp Equipment Finance, Inc.] acquired Firststar's rights under the relevant loan documents.

After the tragic events of September 11, 2001, all parties agree that the airline and airplane market was devastated. In August and September of 2002, Continental Airlines decided not to renew the leases on the Ananya Airplanes, and returned the aircraft to Ananya. Both planes were returned to Ananya in a damaged condition. Damages included an unserviceable engine and an inferior auxiliary power unit installed by Continental. Additionally, both airplanes required expensive inspections. Following the failure of Continental to renew the leases, Ananya did not make the balloon payment that came due in September 2002.

Meanwhile, U.S. Airways filed for bankruptcy following 9/11. As part of the bankruptcy proceedings, U.S. Airways terminated the lease and returned the Ameriquest Airplane to Ameriquest. U.S. Airways made its last lease payment in June 2002. Following the termination of the lease, Ameriquest failed to make its quarterly payments to USBEF, and also failed to make the balloon payment that came due in April 2003.

Following the defaults by Ananya and Ameriquest, USBEF had the option to repossess the Ameriquest and Ananya Airplanes. However, USBEF gave Ameriquest and Ananya time to sell or refinance the airplanes. Gupta suggested to USBEF that he re-lease the planes to overseas operators in countries including Pakistan, Nigeria, and Indonesia. The loan agreements required USBEF's consent before Ananya or Ameriquest could re-lease the planes. In addition to obtaining USBEF's consent to re-lease the planes, Defendants were required to refinance the loans or convince USBEF to extend the maturity dates of the loans, as the balloon payments on all the loans were due and owing by April 2003.

Gupta and USBEF also looked into the possibility of an outright sale of the airplanes. USBEF received an offer for the Ameriquest Airplane, but Gupta did not consent to the sale. Instead, Gupta put together an investment group in an attempt to purchase the Ameriquest Airplane. On January 16, 2003, Gupta's group made an offer of \$540,000 for the airplane. On February 6, the group lowered its offer to \$525,000. On March 25, the group submitted a third offer in the amount of \$300,000. Shortly after this offer from Gupta, USBEF decided to foreclose on the Ameriquest Airplane and sell it through a private sale. Although USBEF communicated this information to Gupta, his group continued to make offers on the Ameriquest Airplane.

Ultimately, USBEF foreclosed on and sold the Ameriquest and Ananya Airplanes. The Ameriquest Airplane was sold for \$450,000. At the public auction for the Ananya Airplanes, USBEF bid a total of \$2,900,000 for the two aircraft. Following the sale of the aircraft, USBEF applied the \$450,000 from the Ameriquest Airplane

sale to Ameriquest debt. Additionally, USBEF applied the proceeds from the \$2,900,000 it bid on the Ananya aircraft to Ananya's debt.

After applying these payments, the principal balance on the Ameriquest note as of August 27, 2004 was \$2,986,960.45, with \$315,586.36 owed in interest. The interest on the Ameriquest note is accruing at the rate of \$871.03 per day. The balance on the Ananya notes as of August 27, 2004 was \$6,736,443.08, with total unpaid interest equal to \$684,008.04. Interest is accruing at the rate of \$1,915.99 per day on the Ananya notes.

Federal Rule of Civil Procedure 56(c) provides that summary judgment shall issue "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). On a motion for summary judgment, the Court views the evidence in the light most favorable to the nonmoving party.

It is undisputed that Defendants have defaulted on the loans at issue. Gupta conceded at his deposition that Ameriquest failed to make its required quarterly payments, as well as the balloon payment due in April 2003. Similarly, as admitted by Gupta, Ananya failed to make the balloon payment due in September 2002. Moreover, it is undisputed that Gupta has never paid either of the \$1,000,000 guaranties he signed with respect to the Ananya Airplanes.

Defendants have offered a number of defenses to their default of the relevant loans. [The court goes through several of them, finding them invalid.]

Defendants have also raised the defense of impossibility and force majeure. Under New York law, impossibility may be raised if one of two conditions is met: (1) the subject matter of the contract is destroyed; or (2) the means of performance is destroyed so as to make performance objectively impossible. *Kel Kim Corp. v. Central Markets, Inc.*, 519 N.E.2d 295, 296 (N.Y. 1987). However, "that performance should be excused only in extreme circumstances." *Id.* Moreover, "financial difficulty or economic hardship, even to the extent of insolvency or bankruptcy," are not sufficient circumstances for a finding of impossibility. *407 East 61st Garage, Inc. v. Savoy Fifth Ave. Corp.*, 244 N.E.2d 37, 41 (N.Y. 1968).

Here, Defendants do not argue that the subject matter of the contract—the airplanes—was destroyed. Rather, Defendants contend performance was rendered impossible by the events of 9/11. Following 9/11, the airplane and airline market around the world suffered immense losses. Numerous airlines went bankrupt (including U.S. Airways), while other airlines simply ceased operations. While the Court is sympathetic to Defendants' plight, the crash of the airline and airplane industry does not rise to the level of impossibility demanded by New York law. Certainly, 9/11 radically depressed the market for airplanes. However, decreased value of collateral is not contemplated by New York law as an excuse for lack of

performance based on impossibility. As New York courts have made plain, the fact that a contract proves to be unprofitable or onerous for one party does not excuse performance. *407 East 61st Garage*, 244 N.E.2d at 41. Investments gone bad due to unforeseen market forces undoubtedly are also captured in this rubric.

Additionally, Defendants claim that USBEF made performance impossible by failing to approve leases of the aircraft to foreign operators. Defendants do not cite any provision of the loan agreements, however, that affirmatively requires USBEF to approve leases. Nor do Defendants cite any case law suggesting that a failure to approve a lease constitutes impossibility of performance.

Based on the foregoing, and all the files, records and proceedings herein, IT IS HEREBY ORDERED that Plaintiff's Motion for Summary Judgment is GRANTED.

Review Question 5. “Here,” says the *U.S. Bancorp* court, “Defendants do not argue that the subject matter of the contract—the airplanes—was destroyed. Rather, Defendants contend performance was rendered impossible by the events of 9/11.” How is that argument any different from Alexandra Bush’s contentions regarding her African safari trip?

Problems

Problem 22.1

Bob is a famous professional athlete in Metropolis. He is hired by RealSports, a regional chain of athletic apparel superstores, to appear at the grand opening of their newest store in Metropolis. The contract provides that Bob will arrive for the grand opening of the store at 9:00 a.m., will sign autographs in two two-hour sessions, and will do an afternoon free sports clinic for school children at a nearby park. Bob is to receive \$50,000 for his appearance. RealSports spends several times that in advertising for the opening on television, radio, newspapers, and social media, all of which tout Bob's attendance at the opening. Two days before the scheduled visit, Bob is arrested for drunk driving. When apprehended, he physically assaults a police officer, pulls a gun, and is forcibly subdued. When his car is searched, a substantial amount of illegal drugs—chiefly cocaine—is found. Bob is taken to jail and booked on several felony charges. The news spreads quickly, and soon every sports outlet in the country is talking about little else than Bob and his arrest.

(a) At Bob's bail hearing the next day, bail is set at \$1 million. Bob is strapped for cash (which is one of the reasons he is doing store openings), although he could

raise the bail money by taking out a loan or selling assets. He does not do so. Instead, he notifies RealSports that he will not be at the opening because he is in jail. If RealSports sues, and Bob claims impracticability, what result and why?

(b) Assume instead that Bob is released on his own recognizance after the incident. Needing money to pay for a lawyer, he is determined to attend the opening. RealSports, however, tells him that it is repudiating the contract and will not pay him. If Bob sues, what is RealSports's defense? What result?

Problem 22.2

Mary lives in Illinois. Her husband has always dreamed of an African safari vacation. As a special 10th wedding anniversary trip, on July 15 she secretly books a luxury safari package for the two of them, which will begin on November 15. The trip is designed as a surprise, and none of her family members (including her two toddlers) know about it. The total cost, including airfare, is \$20,000. The contract provides that she is to put \$5,000 down as a deposit. If she cancels more than 60 days before the date of the vacation (in this case, September 15), she will be charged a cancellation fee of \$200. If she cancels less than 60 but more than 30 days before the event (October 15), she forfeits her deposit. If she cancels after that she is liable for the full purchase price. She provides a credit card guaranteeing the full price.

On August 15, Mary's husband announces that he has decided to leave her and wants a divorce. Mary is distraught. The next day, while driving to a lawyer's office, her car is struck by a truck and she is seriously injured. She is rushed to intensive care with massive internal bleeding, several broken bones, and head injuries. Her life is saved, but she is in a coma and is unable to communicate. She comes out of the coma on October 20, but is still very weak, and will be in a wheelchair for several months and will not physically be able to travel herself for at least a month. Two days later, thinking of the trip, she asks her sister to try and cancel it for her. The tour company, which is based in New York, had charged her credit card for the full price on October 16, as per the agreement. Despite hearing Mary's story, the tour company refuses to refund the money. The company representative explains that if she had not wanted to be liable, she should have purchased travel insurance.

Mary sues to recover her payment from the tour company. Can she do so? On what theory or theories? If so, how much should she recover?

Problem 22.3

Shipper signs a contract with Carrier to transport 750,000 barrels of oil from a field in Kuwait to the oil terminal at Carteret, New Jersey. The oil is to be shipped on June 1. The contract between Shipper and Carrier does not specify the route that the oil will take, but Carrier's plan is to use the normal route, which involves sending

an oil tanker down the Persian Gulf, around the Arabian Peninsula, through the Suez Canal, across the Mediterranean through the Straits of Gibraltar, and then across the Atlantic.

The day before the oil is to be loaded, the Egyptian government—as a result of growing tensions in the Middle East—closes the Suez Canal to American-bound traffic. International protests are fruitless. Carrier’s only option to performing the contract is to load the oil and transport it south along the African coast—through pirate-infested Somali waters—and around the Cape of Good Hope. This will, in effect, double the cost to transport the oil, and increase the insurance costs of the voyage. Carrier refuses to honor the contract, claiming that performance is impracticable due to the government. Shipper ultimately finds another carrier who will transport the oil at a much higher price, and then sues Carrier for breach. What result?



AMERICAN CONTRACT LAW FOR A GLOBAL AGE

Chapter VIII: Remedies

Unit 23: The Expectation Interest

Unit 24: Restitution and Reliance

Unit 25: Limits on Damages

Unit 26: Special Remedies

An Introduction to REMEDIES

We now turn to one of the most important practical questions that you and your clients will face. Let's assume we have a contract, there are no valid defenses, we understand what each party is supposed to do, we have a breach, and the breach is unexcused. That leads to one big question that your clients will want you to answer

So what?

In other words, what is it your client will be entitled to? Clients generally do not bring breach of contract suits to vindicate some moral or philosophical principle. They bring them to get something, usually money, from the other party. They want a *remedy*. If a client is unlikely to be able to get a valuable remedy—or if the remedy will be unenforceable because the other party is broke—the contract dispute is likely a waste of time. Thus, while we believe all of the rest of the course is important (or we wouldn't be covering it), the question of damages is the one that, in practical terms, is perhaps the most important and the most ubiquitous. The client usually does not care that it can prove breach of contract if there is no commensurate remedy—the metaphorical pot of gold at the end of the contract litigation rainbow—for doing so. Not every contract suit will involve questions of consideration, formation, contract defenses, or other issues, but virtually every contract dispute will involve the question: *What should the plaintiff get?*

Types of Remedies. Three broad general categories of remedies are available in a claim for breach of contract. Any of the remedies may be available in any given dispute, but a party can normally only get one. Knowing which one to seek and how to prove it is critical for a successful business litigator.

The first type is *money damages*. The goal is to make the injured party whole by providing a sum of money to compensate the plaintiff. There are, as it happens, also three types of money damages, what we call the *expectation*, *restitution*, and *reliance* measures. Exactly what each of those terms mean, and how they are used, will have to be explored in some detail. Money damages are by far the most commonly granted remedies in the United States.

The second is *liquidated damages*. In other words, damages that the parties have agreed in advance that they would pay if the contract were breached. Just as the parties can agree on other terms of their agreement, they can, within some important limits, provide their own remedies. Understanding the limits, however, requires some study.

The third is *specific performance*, which essentially is an order from a court, very much like an injunction, compelling a party to do what it was supposed to do. In many modern legal systems, this is the most common remedy, but in the U.S. it is available only in very limited circumstances. You will see that when it is available it may sometimes be the most desirable for your client.

Self-Help. Before we move to judicial remedies for breach, however, we want to note an important remedy that does not rely on a lawsuit: self-help. When one party breaches a contract, the other party may acquire certain rights that do not depend on going to court. These include such things as refusing payment, rejecting incorrect goods, suspending deliveries, and so forth. You have already seen parties doing this through this book. Many of these rights are granted by contract law. For example, in the face of a breach the non-breaching party can often suspend its own performance, withhold promised payments, and refuse to return products. See, for example, UCC § 2-705, which expressly permits sellers to withhold or stop delivery of goods upon certain breaches by the buyer. Throughout the course, we have seen scores of situations where parties take protective actions before litigation, some of which were permissible while others were not. But good transactional lawyers know that it is possible to protect clients in advance by thinking about issues and addressing them ahead of time. A lawyer might give her client greater rights of self-enforcement, such as by using carefully thought out uses of conditions and allocations of discretionary authority.

Thinking about what might happen in the event of breach is something clients often are not good at, but lawyers are. Understanding contract remedies will be a great help in protecting your clients in the event of breach.

Unit 23: The Expectation Interest

REMEDIES Part One

FOCUS OF THIS UNIT

Money Damages. The most common remedy for breach of contract, as we noted above, is money damages. The court compels the breaching party to pay something to the non-breaching party. In the early days of the English common law, the issue of how damages should be computed did not often arise; the question was one for the jury, and the jury's determination—however it was calculated—ordinarily was final. During the 19th century, however, British and American courts began to reconsider the wisdom of allowing juries to set whatever damages they chose. They began to develop standards against which damages awards are to be measured.

The key to understanding contract damages is that they are ostensibly awarded only to correct a *private* wrong, not to vindicate a public interest. Therefore, while criminal fines and punitive damages in tort are designed to punish malefactors and discourage others, contract damages are only supposed to make the victim (the non-breaching party) whole. Anything more than that is often called a “windfall” by the courts and will be struck down.

In the materials that follow, in this unit and the next, you will see that the concept of making the non-breaching party “whole” is easier to state than it is to apply. Contract law has actually developed three distinct measures of damages for breach. By far the most prominent is what we call the “expectancy” or “expectation” measure, and it is the subject of this unit. You will see that the expectancy measure sounds simple, but actually can be applied in a few different ways to yield different amounts. In addition to expectancy, courts have also developed two measures called “restitution” and “reliance” that will be covered in the next unit.

We will let you get right to the cases, but we caution you that damages calculations actually run backwards.

Ladies and Gentlemen, Sharpen Your Pencils! Be aware that this part of the course involves math, a subject of which some law students are not especially fond. The math is not difficult, however, usually sticking to addition, subtraction, multiplication and (very rarely) division. If you are particularly math-phobic, you

may want to keep a calculator handy during the discussion of remedies. Remember the overall goal is to make the non-breaching party *whole*—that number is the lodestar you will be looking for. If you find yourself doing a calculation and coming up with a number that is not the amount that will make the party whole, the calculation—no matter how well you did it—is wrong.

As you read the materials that follow, you may want to review Restatement (Second) of Contracts §§ 344-348, which provide an introduction to remedies in general and expectancy damages in particular.

Cases and Materials

HAWKINS v. McGEE

Supreme Court of New Hampshire
84 N.H. 114, 146 A. 641 (1929)

BRANCH, J.

[George Hawkins was a young man the palm of whose hand had been badly burned nine years earlier by an electric wire, and which had a severe quantity of scar tissue. Defendant McGee was a surgeon who wanted to experiment with skin grafting, and repeatedly solicited Hawkins and his father to allow him to take skin off Hawkins's chest to graft on the palm. Evidence put on by Hawkins showed that Dr. McGee had said, "I will guarantee to make the hand a hundred per cent perfect hand" or "a hundred per cent good hand." The operation did not go well, with the hand becoming matted with hair and having a restricted range of motion. Hawkins sued, claiming the hand was not as good as he had been promised. The jury found that the physician was not professionally negligent, and so Hawkins could not recover in tort. But the jury found for Hawkins on his claim that McGee had made a warranty and that the warranty was breached.¹ The court then turned to the issue of damages.]

The substance of the charge to the jury on the question of damages appears in the following quotation: "If you find the plaintiff entitled to anything, he is entitled to recover for what pain and suffering he has been made to endure and what injury he has sustained over and above the injury that he had before." To this instruction the defendant seasonably excepted. By it, the jury was permitted to consider two elements of damage, (1) pain and suffering due to the operation, and (2) positive ill

¹ [Note some good lawyering here on behalf of Hawkins. The medical malpractice claim failed because there was no professional negligence by Dr. McGee—an unsurprising result given that the skin-grafting surgery was new and experimental at the time. Hawkins's lawyers, however, managed to win the case on a breach of contract theory. Even personal injury lawyers can sometimes benefit from stuff they learn in Contracts class. – Eds.]

effects of the operation upon the plaintiff's hand. Authority for any specific rule of damages in cases of this kind seems to be lacking, but when tested by general principle and by analogy, it appears that the foregoing instruction was erroneous.

By "damages" as that term is used in the law of contracts, is intended compensation for a breach, measured in the terms of the contract. The purpose of the law is to put the plaintiff in as good a position as he would have been in had the defendant kept his contract. The measure of recovery is based upon what the defendant should have given the plaintiff, not what the plaintiff has given the defendant or otherwise expended. The only losses that can be said fairly to come within the terms of a contract are such as the parties must have had in mind when the contract was made, or such as they either knew or ought to have known would probably result from a failure to comply with its terms.

The present case is closely analogous to one in which a machine is built for a certain purpose and warranted to do certain work. In such cases, the usual rule of damages for breach of warranty in the sale of chattels is applied and it is held that the measure of damages is the difference between the value of the machine if it had corresponded with the warranty and its actual value, together with such incidental losses as the parties knew or ought to have known would probably result from a failure to comply with its terms. "As a general rule, the measure of the vendee's damages is the difference between the value of the goods as they would have been if the warranty as to quality had been true, and the actual value at the time of the sale, including gains prevented and losses sustained, and such other damages as could be reasonably anticipated by the parties as likely to be caused by the vendor's failure to keep his agreement, and could not by reasonable care on the part of the vendee have been avoided." *Union Bank v. Blanchard*, 18 A. 90, (N.H. 1888). We, therefore, conclude that the true measure of the plaintiff's damage in the present case is the difference between the value to him of a perfect hand or a good hand, such as the jury found the defendant promised him, and the value of his hand in its present condition, including any incidental consequences fairly within the contemplation of the parties when they made their contract. Damages not thus limited, although naturally resulting, are not to be given.

The extent of the plaintiff's suffering does not measure this difference in value. The pain necessarily incident to a serious surgical operation was a part of the contribution which the plaintiff was willing to make to his joint undertaking with the defendant to produce a good hand. It was a legal detriment suffered by him which constituted a part of the consideration given by him for the contract. It represented a part of the price which he was willing to pay for a good hand, but it furnished no test of the value of a good hand or the difference between the value of the hand which the defendant promised and the one which resulted from the operation.

It was also erroneous and misleading to submit to the jury as a separate element of damage any change for the worse in the condition of the plaintiff's hand resulting from the operation, although this error was probably more prejudicial to the plaintiff than to the defendant. Any such ill effect of the operation would be included under the true rule of damages set forth above, but damages might properly be assessed for the defendant's failure to improve the condition of the hand even if there were no evidence that its condition was made worse as a result of the operation.

It must be assumed that the trial court, in setting aside the verdict, undertook to apply the same rule of damages which he had previously given to the jury, and since this rule was erroneous, it is unnecessary for us to consider whether there was any evidence to justify his finding that all damages awarded by the jury above \$500 were excessive.

Review Question 1. Make note of the legal standard used by the *Hawkins v. McGee* court. How does it square with the way things are phrased in sections 347-348 of the Restatement (Second) of Contracts? Are the rules different, or are they basically the same as what the *Hawkins* court describes?

Review Question 2. How much more is a perfect hand worth than a hairy hand, and how would one calculate that? At one point in *Hawkins*, the court describes the case as "closely analogous to one in which a machine is built for a certain purpose and warranted to do certain work." If the seller of a machine breached a warranty of its quality, how would the buyer's damages be calculated? Consult UCC § 2-714 in answering this last question.

Review Question 3. The *Hawkins* court asks us to compare the current situation with an alternative set of events that did not actually occur. A problem with this approach is that it is very difficult to actually predict a future that did not happen. As you read the *U.S. Naval Institute* case that follows, pay attention to how the court goes about calculating a specific dollar amount based on a state of affairs that *did not* happen. See if you can explain the court's reasoning to a trusted classmate—or even to some other person who you think you can subject to that sort of thing.

UNITED STATES NAVAL INSTITUTE v. CHARTER COMMUNICATIONS, INC.

United States Court of Appeals for the Second Circuit
936 F.2d 692 (2d Cir. 1991)

KEARSE, Circuit Judge

[Tom Clancy's novel *The Hunt for Red October* was published in hardcover by the Naval Institute Press in 1984. In September 1984, Naval entered into a contract with Berkley Publishing Group to publish a paperback edition of the book, "not sooner than October 1985." The reason for delayed publication was to allow Naval to maximize hardcover sales over the coming year. The book became an unexpected best-seller, and in breach of the contract, Berkley deliberately began selling copies of the paperback on September 15, and by October 1 the paperback was already near the top of the best-seller lists. Naval sued on a variety of theories, including copyright infringement and breach of contract. Naval sought to recover for its own lost sales—the money it would have made on hardback sales between September 15 and October 1 if the paperback had not been available—and also sought to recover \$724,300 in profits made by Berkley on the unauthorized paperback sales during that period. The trial court, after a hearing, awarded \$35,380.50 for breach of contract, \$7,760.12 in copyright damages, and \$15,319.27 in prejudgment interest. The Second Circuit reversed the copyright infringement claim but affirmed the breach of contract. It turned to the damages calculation.]

Since the purpose of damages for breach of contract is to compensate the injured party for the loss caused by the breach, those damages are generally measured by the plaintiff's actual loss, *see, e.g.*, Restatement (Second) of Contracts § 347 (1981). While on occasion the defendant's profits are used as the measure of damages, this generally occurs when those profits tend to define the plaintiff's loss, for an award of the defendant's profits where they greatly exceed the plaintiff's loss and there has been no tortious conduct on the part of the defendant would tend to be punitive, and punitive awards are not part of the law of contract damages. *See generally id.* § 356 cmt a ("The central objective behind the system of contract remedies is compensatory, not punitive."); *id.* cmt b (agreement attempting to fix damages in amount vastly greater than what approximates actual loss would be unenforceable as imposing a penalty); *id.* § 355 (punitive damages not recoverable for breach of contract unless conduct constituting the breach is also a tort for which such damages are recoverable).

Here, the district court found that Berkley's alleged \$724,300 profits did not define Naval's loss because many persons who bought the paperback in September 1985 would not have bought the book in hardcover but would merely have waited until the paperback edition became available. This finding is not clearly erroneous,

and we turn to the question of whether the district court's finding that Naval suffered \$35,380.50 in actual damages was proper.

In reaching the \$35,380.50 figure, the court operated on the premise that, but for the breach by Berkley, Naval would have sold in September the same number of hardcover copies it sold in August. Berkley challenges that premise as speculative and argues that since Naval presented no evidence as to what its September 1985 sales would have been, Naval is entitled to recover no damages. It argues alternatively that the court should have computed damages on the premise that sales in the second half of September, in the absence of Berkley's premature release of the paperback edition, would have been made at the same rate as in the first half of September. Evaluating the district court's calculation of damages under the clearly erroneous standard of review, we reject Berkley's contentions.

The record showed that, though there was a declining trend of hardcover sales of the Book from March through August 1985, Naval continued to sell its hardcover copies through the end of 1985, averaging some 3,000 copies a month in the latter period. It plainly was not error for the district court to find that the preponderance of the evidence indicated that Berkley's early shipment of 1,400,000 copies of its paperback edition, some 40% of which went to retail outlets and led to the Book's rising close to the top of the paperback best-seller lists before the end of September 1985, caused Naval the loss of some hardcover sales prior to October 1985.

As to the quantification of that loss, we think it was within the prerogative of the court as finder of fact to look to Naval's August 1985 sales. Though there was no proof as to precisely what the unimpeded volume of hardcover sales would have been for the entire month of September, any such evidence would necessarily have been hypothetical. But it is not error to lay the normal uncertainty in such hypotheses at the door of the wrongdoer who altered the proper course of events, instead of at the door of the injured party. *See, e.g.*, Restatement (Second) of Contracts § 352 cmt. a ("Doubts are generally resolved against the party in breach."). The court was not required to use as the starting point for its calculations Naval's actual sales in the first half of September, *i.e.*, those made prior to the first retail sale of the paperback edition. Berkley has not called to our attention any evidence in the record to indicate that the sales in a given month are normally spread evenly through that month. Indeed, it concedes that "to a large degree, book sales depend on public whim and are notoriously unpredictable." Thus, nothing in the record foreclosed the possibility that, absent Berkley's breach, sales of hardcover copies in the latter part of September would have outpaced sales of those copies in the early part of the month. Though the court accurately described its selection of August 1985 sales as its benchmark as "generous," it was not improper, given the inherent uncertainty, to exercise generosity in favor of the injured party rather than in favor of the breaching party.

In all the circumstances, we cannot say that the district court's calculation of Naval's damages was clearly erroneous.

Review Question 4. This case may seem overly technical on first read. Note that what the court faces is the same question that writers of “alternative history” novels have to face: What would the world be like if things had happened differently? Carefully consider the evidence the court discusses and note how the court goes about constructing a sort of parallel world. In proving damages, lawyers frequently must find ways to do this sort of thing.

Review Question 5. Suppose you have a seller (such as General Motors was before its 2009 restructuring) that loses money on every transaction it enters into. Is it possible that such a seller would have damages if one of those losing contracts were breached? Maybe the seller should thank the breaching party for stemming its loss. The *Leingang* case below seems to suggest that there might actually be compensable damages, however. As you read *Leingang*, see if you can articulate why this is so. Your professor just might ask for your explanation in an upcoming class.

LEINGANG v. CITY OF MANDAN WEED BOARD

Supreme Court of North Dakota
468 N.W.2d 397 (N.D. 1991)

LEVINE, J.

Robert Leingang appeals from an award of damages for breach of contract. The issue is whether the trial court used the appropriate measure of damages. We hold it did not, and reverse and remand.

The City of Mandan Weed Board awarded Leingang a contract to cut weeds on lots with an area greater than 10,000 square feet. Another contractor received the contract for smaller lots. During 1987, Leingang discovered that the Weed Board’s agent was improperly assigning large lots to the small-lot contractor. Leingang complained and the weed board assigned some substitute lots to him.

Leingang brought a breach of contract action in small claims court and the City removed the action to county court. The City admitted that it had prevented Leingang’s performance under the contract and that the contract price for the lost work was \$1,933.78. A bench trial was held to assess the damages suffered by Leingang.

At trial, Leingang argued that the applicable measure of damages was the contract price less the costs of performance he avoided due to the breach. Leingang

testified that the total gas, oil, repair and replacement blade expenses saved when he was prevented from cutting the erroneously assigned lots was \$211.18.

The City argued that to identify Leingang's damages for net profits, some of Leingang's overhead expenses should be attributed to the weed cutting contract and deducted from the contract price. The City offered testimony about the profitability of businesses in Mandan and testimony from Leingang's competitor about the profitability of a weed cutting business in Mandan. The City also offered Leingang's 1986 and 1987 federal tax returns. Based on the Schedule C—"Profit or Loss From Business"—in those returns, the City argued that Leingang attributed considerably more expenses to the business of cutting weeds than he had testified he had avoided.

The trial court adopted what it called a "modified net profit" approach as the measure of damages. It derived a profit margin of 20% by subtracting four categories of expenses reported on Leingang's Schedule C, and attributed to the weed-cutting business, from the weed-cutting income reported to the IRS. The trial court selected insurance, repairs, supplies, and car and truck expenses as costs attributed to the weed-cutting business. Applying the profit margin of 20% to the contract price, the trial court deducted 80% from the contract price as expenses and awarded Leingang \$368.59 plus interest. Leingang appeals.

Leingang contends that the method used by the trial court to derive net profits was improper because it did not restrict the expenses that are deductible from the contract price to those which would have been incurred but for the breach of the contract, *i.e.*, those expenses Leingang did not have to pay because the City kept him from doing the work. We agree.

For a breach of contract, the injured party is entitled to compensation for the loss suffered, but can recover no more than would have been gained by full performance. N.D. Civ. Code §§ 32-03-09, 32-03-36. Our law thus incorporates the notion that contract damages should give the nonbreaching party the benefit of the bargain by awarding a sum of money that will put that person in as good a position as if the contract had been performed. Where the contract is for service and the breach prevents the performance of that service, the value of the contract consists of two items: (1) the party's reasonable expenditures toward performance, including costs paid, material wasted, and time and services spent on the contract, and (2) the anticipated profits. Thus, a party is entitled to recover for the detriment caused by the defendant's breach, including lost profits if they are reasonable and not speculative.

Where a plaintiff offers evidence estimating anticipated profits with reasonable certainty, they may be awarded. *See King Features Syndicate v. Courier*, 43 N.W.2d 718 (Iowa 1950). In *King Features*, the plaintiff proved the value of its anticipated profits by reducing the contract price by the amount it would have spent to perform. The court held that this proof was reasonably certain. In quantifying the costs of performance, the plaintiff did not deduct "overhead" expenses because the

evidence established that those expenses were constant whether or not the contract was performed.

The *King Features* approach fulfills the *Welsh Manufacturing* requirement that a plaintiff be compensated for all the detriment caused by the breach. Under *King Features*, constant overhead expenses are not deducted from the contract price because they are expenses the plaintiff had to pay whether or not the contract was breached. The *King Features* approach compensates plaintiff for constant overhead expenses by allowing an award of the contract price, reduced only by expenses actually saved because the contract did not have to be performed. The remaining contract proceeds are available to pay constant expenses. *See also Buono Sales, Inc. v. Chrysler Motors Corp.*, 449 F.2d 715, 720 (3d Cir. 1971) (because fixed expenses must be paid from the sum remaining after costs of performance are deducted, further reducing contract price by fixed expenses would not fully, or fairly, compensate plaintiff).

Neither side argues that lost profits are not calculable here. Instead, each urges a different method for computing lost profits. In measuring Leingang's anticipated profits, the trial court erroneously calculated a "net profit" margin by deducting general costs of doing business including insurance, repairs, supplies, and car and truck expenses, without determining whether these costs remained constant regardless of the City's breach and whether they were, therefore, not to be deducted from the contract price. The reduction from the contract price of a portion of the "fixed," or constant expenses, effectively required Leingang to pay that portion twice.

We reverse the judgment and remand for a new trial on the issue of damages.

Review Question 6. Understanding *Leingang* requires understanding the difference between two kinds of expenses, often called "direct" and "indirect." Put very simply, direct costs are those that vary directly with the number of units sold, while indirect (sometimes called "overhead") costs are incurred regardless of the number of units sold. At a hamburger stand, for example, the number of patties and buns you need depend on how many burgers you sell and are thus direct costs. The manager's salary and the property tax on the building, however, must be paid even if you sell no burgers at all—making those costs indirect. The price of the burgers must ultimately cover *both* of those business expenses. How might you describe the reasoning in *Leingang* based on these concepts of direct and indirect costs?

BRANDEIS MACHINERY & SUPPLY CO., LLC v. CAPITOL CRANE RENTAL, INC.

Court of Appeals of Indiana, Fifth District
765 N.E.2d 173 (Ind. Ct. App. 2002)

VAIDIK, J.

[Capitol had been renting a crane from Brandeis. The parties signed a contract under which Capitol would purchase the crane, which was already on its property, for \$291,773.46. The contract provided that Capitol would pay the full price within ten days, or would face a “service charge” of two percent per month. Capitol then changed its mind. Before paying the purchase price, Capitol returned the crane, in somewhat damaged condition, to Brandeis. Brandeis sued, demanding the full purchase price plus an accumulated \$159,302.38 in service charges and the costs of inspection and repair, \$9,794.86, for a total of \$460,870.70. The trial court found that Capitol was in breach, but awarded a considerably smaller sum. Brandeis appealed.]

In particular, Brandeis maintains that the trial court erred by failing to award the contract price and by failing to include service charges for late payment according to the terms of its contract with Capitol Crane Rental, Inc.

Capitol maintained that no damages should have been awarded. In the alternative, Capitol submitted that damages should be calculated by subtracting the fair market value of the Crane from the Contract price of \$291,773.46.

Regarding the fair market value of the Crane, Henry testified that based on rates of depreciation the Crane’s fair market value in June/July 1999 was between \$270,000 and \$275,000. Due to the difference, Capitol suggested using the median value of \$272,500. The difference between the median fair market value of \$272,500 and the Contract price of \$291,773.46 is a damage award of \$19,273.46.

The trial court entered judgment in favor of Brandeis on June 21, 2001. The trial court ordered that “Brandeis Machinery & Supply Co., LLC, recover of and from the defendant, Capitol Crane Rentals, Inc., the sum of \$29,067.00 with interest thereon from the date of judgment, as provided by law, plus costs of this action.” This appeal ensued.

Brandeis asserts that the trial court erred in calculating the damage award. Brandeis contends that the trial court erred by failing to award the full Contract price when calculating the damages.

Indiana Code § 26-1-2-709(3) provides that after a buyer has wrongfully rejected goods, a seller is not entitled to price but shall be awarded damages for nonacceptance under § 26-1-2-708. Damages for nonacceptance are defined as:

the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages . . . but less expenses saved in consequence of the buyer’s breach.

Thus, damages for a wrongful rejection are limited to the difference between the market value of the goods and the unpaid contract price together with any incidental damages.

Turning to our case, we are reminded that we may not re-weigh the evidence and must sustain the trial court on any legal theory. Given our standard of review, the trial court could have concluded that Capitol made a wrongful, but effective rejection of the Crane. Capitol's rejection was wrongful because it was not based on any non-conformity.

In this case, the trial court could have justifiably concluded that Capitol returned the Crane within a reasonable time and provided seasonable notification of its rejection of the Crane. As to the timing of the return, Capitol's owner, Dotlich, testified that shortly after the contract was signed in June of 1999, he returned the Crane to Brandeis' lot and told an employee of Brandeis that he no longer wanted to buy it. Furthermore, Brandeis had a pattern of canceling contracts in the past after customers had signed them, but before money had changed hands.

The appropriate calculation of damages is the difference between the contract price and the market price at the time of delivery plus incidental damages. Ind. Code § 26-1-2-709(3); Ind. Code § 26-1-2-708. Therefore, we find that the trial court did not err when it declined to include the Contract price in the damage award.

By calculating the difference between the contract price and the market price, Brandeis would receive \$19,273.46. The trial court awarded Brandeis the sum of \$29,067. By examining the post-trial briefs filed by the parties which outlined their individual damage calculations, we can infer that the trial court's damage award includes the difference between the Contract price and the fair market value of the Crane which is \$19,273.46 and the cost of the inspection of the repairs which cost \$9,794.86.

Judgment affirmed.

Review Question 7. Wouldn't the simpler thing in *Brandeis Machinery* be to just give the seller the contract price plus the late payment fees provided for in the contract? Why then does the court spend considerable time trying to calculate some *other* remedy? What would the problem be with giving the plaintiff here the damages for which it contended?

Review Question 8. The goal of contract damages, it is frequently said, is to "make whole" the breaching party. What position would the seller be in if Capitol had performed? What position is it in after Capitol repudiates? What is the difference between those two states? Has the seller been made whole?

PEEVYHOUSE v. GARLAND COAL & MINING CO.

Supreme Court of Oklahoma
382 P.2d 109 (Okla. 1962)

JACKSON, J.

In the trial court, plaintiffs Willie and Lucille Peevyhouse sued the defendant, Garland Coal and Mining Company, for damages for breach of contract. Judgment was for plaintiffs in an amount considerably less than was sued for. Plaintiffs appeal and defendant cross-appeals.

In the briefs on appeal, the parties present their argument and contentions under several propositions; however, they all stem from the basic question of whether the trial court properly instructed the jury on the measure of damages.

Briefly stated, the facts are as follows: plaintiffs owned a farm containing coal deposits, and in November, 1954, leased the premises to defendant for a period of five years for coal mining purposes. A “strip-mining” operation was contemplated in which the coal would be taken from pits on the surface of the ground, instead of from underground mine shafts. In addition to the usual covenants found in a coal mining lease, defendant specifically agreed to perform certain restorative and remedial work at the end of the lease period. It is unnecessary to set out the details of the work to be done, other than to say that it would involve the moving of many thousands of cubic yards of dirt, at a cost estimated by expert witnesses at about \$29,000. However, plaintiffs sued for only \$25,000.

During the trial, it was stipulated that all covenants and agreements in the lease contract had been fully carried out by both parties, except the remedial work mentioned above; defendant conceded that this work had not been done.

Plaintiffs introduced expert testimony as to the amount and nature of the work to be done, and its estimated cost. Over plaintiffs’ objections, defendant thereafter introduced expert testimony as to the “diminution in value” of plaintiffs’ farm resulting from the failure of defendant to render performance as agreed in the contract—that is, the difference between the present value of the farm, and what its value would have been if defendant had done what it agreed to do.

At the conclusion of the trial, the court instructed the jury that it must return a verdict for plaintiffs, and left the amount of damages for jury determination. On the measure of damages, the court instructed the jury that it might consider the cost of performance of the work defendant agreed to do, “together with all of the evidence offered on behalf of either party.”

It thus appears that the jury was at liberty to consider the “diminution in value” of plaintiffs’ farm as well as the cost of “repair work” in determining the amount of damages.

It returned a verdict for plaintiffs for \$5,000.00—only a fraction of the “cost of performance,” but more than the total value of the farm even after the remedial work is done.

On appeal, the issue is sharply drawn. Plaintiffs contend that the true measure of damages in this case is what it will cost plaintiffs to obtain performance of the work that was not done because of defendant’s default. Defendant argues that the measure of damages is the cost of performance “limited, however, to the total difference in the market value before and after the work was performed.”

It appears that this precise question has not heretofore been presented to this court. In *Ardizonne v. Archer*, 72 Okla. 70, 178 P. 263, this court held that the measure of damages for breach of a contract to drill an oil well was the reasonable cost of drilling the well, but here a slightly different factual situation exists. The drilling of an oil well will yield valuable geological information, even if no oil or gas is found, and of course if the well is a producer, the value of the premises increases. In the case before us, it is argued by defendant with some force that the performance of the remedial work defendant agreed to do will add at the most only a few hundred dollars to the value of plaintiffs’ farm, and that the damages should be limited to that amount because that is all plaintiffs have lost.

Plaintiffs rely on *Groves v. John Wunder Co.*, 205 Minn. 163, 286 N.W. 235. In that case, the Minnesota court, in a substantially similar situation, adopted the “cost of performance” rule as—as opposed to the “value” rule. The result was to authorize a jury to give plaintiff damages in the amount of \$60,000, where the real estate concerned would have been worth only \$12,160, even if the work contracted for had been done.

It may be observed that *Groves* is the only case which has come to our attention in which the cost of performance rule has been followed under circumstances where the cost of performance greatly exceeded the diminution in value resulting from the breach of contract. Incidentally, it appears that this case was decided by a plurality rather than a majority of the members of the court.

Defendant relies principally upon *Sandy Valley & E. R. Co., v. Hughes*, 175 Ky. 320, 194 S.W. 344; *Bigham v. Wabash-Pittsburg Terminal Ry. Co.*, 223 Pa. 106, 72 A. 318; and *Sweeney v. Lewis Const. Co.*, 66 Wash. 490, 119 P. 1108. These were all cases in which, under similar circumstances, the appellate courts followed the “value” rule instead of the “cost of performance” rule. Plaintiff points out that in the earliest of these cases (*Bigham*) the court cites as authority on the measure of damages an earlier Pennsylvania tort case, and that the other two cases follow the first, with no explanation as to why a measure of damages ordinarily followed in cases sounding in tort should be used in contract cases. Nevertheless, it is of some significance that three out of four appellate courts have followed the diminution in value rule under

circumstances where, as here, the cost of performance greatly exceeds the diminution in value.

The explanation may be found in the fact that the situations presented are artificial ones. It is highly unlikely that the ordinary property owner would agree to pay \$29,000 (or its equivalent) for the construction of “improvements” upon his property that would increase its value only about (\$300) three hundred dollars. The result is that we are called upon to apply principles of law theoretically based upon reason and reality to a situation which is basically unreasonable and unrealistic.

In *Groves v. John Wunder Co.*, the Minnesota court apparently considered the contract involved to be analogous to a building and construction contract, and cited authority for the proposition that the cost of performance or completion of the building as contracted is ordinarily the measure of damages in actions for damages for the breach of such a contract.

In an annotation following the Minnesota case beginning at 123 A.L.R. 515, the annotator places the three cases relied on by defendant (*Sandy Valley, Bigham* and *Sweeney*) under the classification of cases involving “grading and excavation contracts.”

We do not think either analogy is strictly applicable to the case now before us. The primary purpose of the lease contract between plaintiffs and defendant was neither “building and construction” nor “grading and excavation.” It was merely to accomplish the economical recovery and marketing of coal from the premises, to the profit of all parties. The special provisions of the lease contract pertaining to remedial work were incidental to the main object involved.

Even in the case of contracts that are unquestionably building and construction contracts, the authorities are not in agreement as to the factors to be considered in determining whether the cost of performance rule or the value rule should be applied. Restatement [First] of Contracts § 346(1)(a) submits the proposition that the cost of performance is the proper measure of damages “if this is possible and does not involve *unreasonable economic waste*”; and that the diminution in value caused by the breach is the proper measure “if construction and completion in accordance with the contract would involve *unreasonable economic waste*.” (Emphasis supplied.) In an explanatory comment immediately following the text, the Restatement makes it clear that the “economic waste” referred to consists of the destruction of a substantially completed building or other structure. Of course no such destruction is involved in the case now before us.

On the other hand, in MCCORMICK, DAMAGES, § 168, it is said with regard to building and construction contracts that “in cases where the defect is one that can be repaired or cured *without undue expense*” the cost of performance is the proper measure of damages, but where “the defect in material or construction is one that

cannot be remedied without *an expenditure for reconstruction disproportionate to the end to be attained*" (emphasis supplied) the value rule should be followed.

In view of the unrealistic fact situation in the instant case, and certain Oklahoma statutes to be hereinafter noted, we are of the opinion that the "relative economic benefit" is a proper consideration here. This is in accord with the recent case of *Mann v. Clowser*, 190 Va. 887, 59 S.E.2d 78, where, in applying the cost rule, the Virginia court specifically noted that "the defects are remediable from a practical standpoint and the costs *are not grossly disproportionate* to the results to be obtained" (Emphasis supplied).

23 Okla. Stat. 1961 §§ 96 and 97 provide as follows:

§ 96. * * * Notwithstanding the provisions of this chapter, no person can recover a greater amount in damages for the breach of an obligation, than he would have gained by the full performance thereof on both sides * * *.

§ 97. * * * Damages must, in all cases, be reasonable, and where an obligation of any kind appears to create a right to unconscionable and grossly oppressive damages, contrary to substantial justice no more than reasonable damages can be recovered.

Although it is true that the above sections of the statute are applied most often in tort cases, they are by their own terms, and the decisions of this court, also applicable in actions for damages for breach of contract. It would seem that they are peculiarly applicable here where, under the "cost of performance" rule, plaintiffs might recover an amount about nine times the total value of their farm. Such would seem to be "unconscionable and grossly oppressive damages, contrary to substantial justice" within the meaning of the statute. Also, it can hardly be denied that if plaintiffs here are permitted to recover under the "cost of performance" rule, they will receive a greater benefit from the breach than could be gained from full performance, contrary to the provisions of § 96.

In spite of the agreement of the parties, §§ 96 and 97 limit the damages recoverable to a reasonable amount not "contrary to substantial justice"; they prevent plaintiffs from recovering a "greater amount in damages for the breach of an obligation" than they would have "gained by the full performance thereof."

We therefore hold that where, in a coal mining lease, lessee agrees to perform certain remedial work on the premises concerned at the end of the lease period, and thereafter the contract is fully performed by both parties except that the remedial work is not done, the measure of damages in an action by lessor against lessee for damages for breach of contract is ordinarily the reasonable cost of performance of the work; however, where the contract provision breached was merely incidental to the main purpose in view, and where the economic benefit which would result to lessor

by full performance of the work is grossly disproportionate to the cost of performance, the damages which lessor may recover are limited to the diminution in value resulting to the premises because of the non-performance.

It should be noted that the rule as stated does not interfere with the property owner's right to "do what he will with his own" *Chamberlain v. Parker*, 45 N.Y. 569, or his right, if he chooses, to contract for "improvements" which will actually have the effect of reducing his property's value. Where such result is in fact contemplated by the parties, and is a main or principal purpose of those contracting, it would seem that the measure of damages for breach would ordinarily be the cost of performance.

Under the most liberal view of the evidence herein, the diminution in value resulting to the premises because of non-performance of the remedial work was \$300.00. After a careful search of the record, we have found no evidence of a higher figure, and plaintiffs do not argue in their briefs that a greater diminution in value was sustained. It thus appears that the judgment was clearly excessive, and that the amount for which judgment should have been rendered is definitely and satisfactorily shown by the record.

We are of the opinion that the judgment of the trial court for plaintiffs should be, and it is hereby, modified and reduced to the sum of \$300.00, and as so modified it is affirmed.

IRWIN, J, dissenting.

By the specific provisions in the coal mining lease under consideration, the defendant agreed as follows:

7b Lessee agrees to make fills in the pits dug on said premises on the property line in such manner that fences can be placed thereon and access had to opposite sides of the pits.

7c Lessee agrees to smooth off the top of the spoil banks on the above premises.

7d Lessee agrees to leave the creek crossing the above premises in such a condition that it will not interfere with the crossings to be made in pits as set out in 7b.

7f Lessee further agrees to leave no shale or dirt on the high wall of said pits.

Following the expiration of the lease, plaintiffs made demand upon defendant that it carry out the provisions of the contract and to perform those covenants contained therein.

Defendant admits that it failed to perform its obligations that it agreed and contracted to perform under the lease contract and there is nothing in the record which indicates that defendant could not perform its obligations. Therefore, in my opinion defendant's breach of the contract was willful and not in good faith.

Although the contract speaks for itself, there were several negotiations between the plaintiffs and defendant before the contract was executed. Defendant admitted in the trial of the action, that plaintiffs insisted that the above provisions be included in the contract and that they would not agree to the coal mining lease unless the above provisions were included.

In consideration for the lease contract, plaintiffs were to receive a certain amount as royalty for the coal produced and marketed and in addition thereto their land was to be restored as provided in the contract.

The cost for performing the contract in question could have been reasonably approximated when the contract was negotiated and executed and there are no conditions now existing which could not have been reasonably anticipated by the parties. Therefore, defendant had knowledge, when it prevailed upon the plaintiffs to execute the lease, that the cost of performance might be disproportionate to the value or benefits received by plaintiff for the performance.

Defendant has received its benefits under the contract and now urges, in substance, that plaintiffs' measure of damages for its failure to perform should be the economic value of performance to the plaintiffs and not the cost of performance.

Defendant did not have the right to mine plaintiffs' coal or to use plaintiffs' property for its mining operations without the consent of plaintiffs. Defendant had knowledge of the benefits that it would receive under the contract and the approximate cost of performing the contract. With this knowledge, it must be presumed that defendant thought that it would be to its economic advantage to enter into the contract with plaintiffs and that it would reap benefits from the contract, or it would have not entered into the contract.

Therefore, if the value of the performance of a contract should be considered in determining the measure of damages for breach of a contract, the value of the benefits received under the contract by a party who breaches a contract should also be considered. However, in my judgment, to give consideration to either in the instant action, completely rescinds and holds for naught the solemnity of the contract before us and makes an entirely new contract for the parties.

In *Great Western Oil & Gas Company v. Mitchell*, 326 P.2d 794, we held:

The law will not make a better contract for parties than they themselves have seen fit to enter into, or alter it for the benefit of one party and to the detriment of the others; the judicial function of a court of law is to enforce a contract as it is written.

In the instant action defendant has made no attempt to even substantially perform. The contract in question is not immoral, is not tainted with fraud, and was not entered into through mistake or accident and is not contrary to public policy. It is

clear and unambiguous and the parties understood the terms thereof, and the approximate cost of fulfilling the obligations could have been approximately ascertained. There are no conditions existing now which could not have been reasonably anticipated when the contract was negotiated and executed. The defendant could have performed the contract if it desired. It has accepted and reaped the benefits of its contract and now urges that plaintiffs' benefits under the contract be denied. If plaintiffs' benefits are denied, such benefits would inure to the direct benefit of the defendant.

Therefore, in my opinion, the plaintiffs were entitled to specific performance of the contract and since defendant has failed to perform, the proper measure of damages should be the cost of performance. Any other measure of damage would be holding for naught the express provisions of the contract; would be taking from the plaintiffs the benefits of the contract and placing those benefits in defendant which has failed to perform its obligations; would be granting benefits to defendant without a resulting obligation; and would be completely rescinding the solemn obligation of the contract for the benefit of the defendant to the detriment of the plaintiffs by making an entirely new contract for the parties.

I therefore respectfully dissent to the opinion promulgated by a majority of my associates.

Review Question 9. What should the goal of compensation be in contract law? In *Groves v. John Wunder Co.*, 286 N.W. 235 (Minn. 1939), the Minnesota Supreme Court—on facts very similar to *Peevyhouse*—awarded the exact cost-of-performance measure of damages that the Oklahoma Supreme Court majority rejected:

The one question for us arises upon plaintiff's assertion that he was entitled, not to that difference in value, but to the reasonable cost to him of doing the work called for by the contract which defendant left undone.

Defendant's breach of contract was willful. There was nothing of good faith about it. Hence, that the decision below handsomely rewards bad faith and deliberate breach of contract is obvious. That is not allowable. [* * *] In reckoning damages for breach of a building or construction contract, the law aims to give the disappointed promisee, so far as money will do it, what he was promised. [* * *]

Even in case of substantial performance in good faith, the resulting defects being remediable, it is error to instruct that the measure of damage is "the difference in value between the house as it was and as it would have been if constructed according to contract." The "correct doctrine" is that the cost of remedying the defect is the "proper" measure of damages.

Value of the land (as distinguished from the value of the intended product of the contract, which ordinarily will be equivalent to its reasonable cost) is no

proper part of any measure of damages for willful breach of a building contract.
The reason is plain.

Both *Groves* and the *Peevyhouse* case from over two decades later have been heavily criticized—the latter for applying the diminished-value test and the former for applying cost of performance in place of it. Which approach is better for putting the injured party in as good a position as if the other had not breached? To what extent does either approach make an unjustified “windfall” to one party more (or less) likely?

Review Question 10. Article 74 of the CISG provides that for breach of an international sales contract, damages “consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach.” How does that formulation for damages compare with the common law and UCC approaches that you have considered in this unit?

Problems

Problem 23.1

(a) Seller agrees to sell his used Ford pickup truck to Andy for \$5,000, which is the “Bluebook” price of the truck in its current condition. Andy breaches. Seller subsequently sells the truck to Betty for \$4,500. What damages can Seller get from Andy?

(b) Same facts, except that Seller breaches. What damages can Andy get from Seller?

(c) Same facts as (b), except that after Seller breaches, Andy buys the same model truck, though a different color, from another person for \$5,500. What damages can Andy get from Seller?

Problem 23.2

(a) Homeowner hires contractor to build an in-ground swimming pool in his back yard. The total price is to be \$15,000. Homeowner pays \$5,000 down. Contractor’s estimated profit on the job is \$4,000. Contractor spends \$2,000 to dig the hole for the pool and prepare for construction. At this point Homeowner claims he is being ripped off by Contractor’s high price and demands a price reduction. Contractor refuses. Homeowner tells Contractor that “the deal is off” and forbids her to come on the property to finish the work. Homeowner hires another pool contractor who agrees to finish the work for \$10,000. If the case goes to trial, what (if any) damages would either party be able to recover from the other?

(b) Same deal, except that after digging the hole and expending \$2,000, it is Contractor who breaches by refusing to return to work. Homeowner hires another

pool contractor to finish the pool for \$10,000. If the case goes to trial, what (if any) damages would either party be able to recover from the other?

Problem 23.3

(a) Buyer contracts with Manufacturer for the production and delivery of 10,000 Texas Rangers jerseys which will be sold in Buyer's store as part of a special promotion. The contract price is \$150,000, and Buyer has paid \$75,000 in advance. The jerseys will retail for \$30 each; Buyer expects to gross \$300,000 on them. When the jerseys arrive on the specified day, Buyer is surprised to see that they say "Ringers," not "Rangers." Buyer rejects the shipment and is not able to find another supplier in time, so it cancels its special promotion. Buyer demands that Manufacturer return its deposit and take back the "Ringers" jerseys. Manufacturer refuses. The jerseys sit in Buyer's loading area for six months without being picked up. Finally, frustrated Buyer sells the 10,000 jerseys for \$30,000 to a novelty and joke store. Buyer eventually sues for breach of contract. What damages, if any, would either party be able to recover from the other?

(b) Same facts, except that the jerseys are not misprinted and conform exactly to the contract requirements. Buyer, however, has decided to cancel its promotion, so it no longer wants the jerseys and refuses to take them. Seller, at a cost of \$1,500, sends a truck to retrieve the jerseys. Seller makes several attempts to sell the shirts, spending about 20 hours of time at \$30 an hour and running up a long-distance phone tab of \$150. Seller ultimately sells the whole lot to a discount sporting goods store, Sports-4-Less, a discount store, for \$60,000. Seller sues Buyer for breach of contract. What damages, if any, would either party be able to recover from the other?

Problem 23.4

Landlord has spent millions of dollars updating a beautiful old office building in the downtown area. The lobby, in particular, was paved, at great expense, with San Francisco Green granite and Canberra York Grey granite, the walls were paneled with sequence-matched crown-cut American cherry. Immediately after the building is finished, it is leased in its entirety for ten years to Bank. The lease gives Bank authority to make modifications to the building, but provides that the building at the end of the lease must be returned in the same condition, minus normal wear and tear. Shortly after taking over the building, Bank decides it wants a more modern-looking lobby, and rips up all of the granite flooring and tears out all of the paneling, disposing of it all in the trash.

At the end of the lease, Bank decides not to renew. It lays a new carpet down in the lobby and paints the walls to freshen them up. Landlord demands that it rebuild the lobby to its original state. Bank refuses, noting that it would cost \$500,000 to do that. Expert appraisers estimate that the total diminution of value is somewhere between zero (some people do not like granite and cherry lobbies) and \$50,000.

Landlord sues for the \$500,000 it will take to rebuild the lobby to its original form.
What damages is Landlord entitled to receive?

Unit 24: Restitution and Reliance

REMEDIES Part Two

FOCUS OF THIS UNIT

By far the most common judicial remedy for breach of contract in the United States is expectation damages, introduced in the previous unit. The expectancy is, however sometimes unavailable or inadequate in certain situations. This unit addresses the two primary alternatives to expectation damages.

Restitution: Returning the Ill-Gotten Gain. The first alternative is *restitution*. The remedy of restitution did not grow up in contract law. You may have run across it in other contexts, such as when a criminal defendant is ordered to “make restitution” to a victim for the harm done. In contract law, however, the concept involves compensating the wronged party with the ill-gotten gain of another—even if the breach has not technically caused measurable economic harm. Restitution has its roots in equity, tort law, and fiduciary law. Over the years, many situations have arisen in which one person wrongfully held the property of another, such as by having stolen, borrowed without returning, or otherwise used property to make money without permission of the property’s true owner. The English courts, relying on the equitable maxim, *commodum ex injuria sua nemo habere debet*—roughly translated, “No one shall profit by his own wrong”—developed a remedy that forced the wrongdoer to pay back what he had obtained.

An early and straightforward English example of restitution involved stable operators who boarded horses for the horses’ owners. When the horse owners were out of town for a prolonged period, the stable operators would rent the horses (much like a modern auto rental business) to other customers. The horse owners did not give permission for their horses to be rented out, and they were unhappy about this apparent breach of contract. Yet, they could show no measurable harm. After all, the horses would have to have been taken out and exercised anyway. With no economic loss, the owners could not prove expectancy damages, even if the stable owners were willfully breaching the contract by renting out the owners’ horses without permission. The transaction was—from an economic perspective, at least—harmless. Nevertheless, the English courts held early on that, in such a situation, the stable owner would be liable to “disgorge”—a polite term for the act of spewing something up and out of one’s stomach—the profits they had made. Thus, the horse owner who

had suffered monetary damage would be awarded damages not for his own loss, but for the *profit* wrongfully made by the other commandeering his property.

A natural step from “you’re using my property” is “you’re using the property (money) that you were supposed to have paid me.” Restitution thus came to be an alternative remedy for breach of contract. In this unit, we will focus on restitution’s specific application in contract law, but keep in mind that the restitution principle of disgorging “unjust enrichment” extends far beyond contract. The principle is so broad, in fact, that the American Law Institute has an entire Restatement on the subject. The *Restatement (Third) of Restitution and Unjust Enrichment* was published in 2011. This enormous and fertile topic takes up much of the course in Remedies, a course you should strongly consider taking later in law school.

Reliance: “But I Trusted You!” The expectation and restitution remedies go back far into the early history of the English common law, and they arrived in America along with the first English colonists. The third major category of damages is much more recent. Even as a conceptual matter, it dates only back to the 1930s, although some cases seem to have applied it occasionally before that. In an influential 1936 law review article, *The Reliance Interest in Contract Law*, Professor Lon Fuller and his then-student, William Perdue, contended not only that reliance was an appropriate alternative remedy for breach of contract, but that it might even be the most appropriate and important remedy in many circumstances.

The idea of a “reliance interest” rests on a simple parallel. Contracts depend upon promises. So, in many cases, does the tort of fraud. Consider the car thief who purports to be the car’s owner and sells it to you for \$5,000. You *relied* on the thief’s statements and you are out \$5,000 when the true owner reclaims her car. Change up the facts a bit, and suppose you had paid the \$5,000 to the car’s true owner, but the owner has taken your money and refused to deliver the car. You *relied* on the owner’s promise, and you are out \$5,000. Assuming you cannot get the car, what can you recover in each case? For fraud, the usual remedy (as you may have learned in torts) is restitution. But in contract, using the expectancy measure would result in the *fair market value of the car*. Fuller and Perdue argued that because both situations involved reliance, using what they called “the reliance interest” as a measure of damages would be appropriate in either situation.

While there was a period of time in the last century where it appeared that the reliance interest might swallow up the expectancy interest, that turned out not to be the case. Expectation damages remain the most common award in breach of contract cases. As a practical matter, getting what you *expected* under a contract is often better than simply getting back *what you spent*, but as you will see from the cases below, that is not always the case.

All three measures of damages—expectancy, restitution, and reliance—are part of the contract litigator’s toolkit. A contract plaintiff can get only one of the three

measures, but at the time a lawsuit begins, it may not be clear which one will most benefit the client, and it may not be clear which one a jury (or a reviewing judge) will conclude is supported by the evidence. A lawyer should therefore understand each of them.

Cases and Materials

A. Restitution

LEE v. FOOTE

District of Columbia Court of Appeals
481 A.2d 484 (D.C. 1984)

PER CURIAM

Appellant appeals the trial court's denial of compensatory damages upon its finding that appellee breached an oral contract for the exchange of services. The trial court awarded appellant only nominal damages of one dollar, ruling that, as a matter of law, he could not recover for the value of services he performed for appellee. We reverse and remand.

The trial court, sitting without a jury, found that Lee and Foote entered into an oral contract for the exchange of services. Lee agreed to perform rough and finished carpentry work on Foote's house at 1926 Eleventh Street, N.W., and Foote agreed to perform plumbing work on Lee's house at 467 M Street, N.W. Lee did rough carpentry work on Foote's house for approximately 30 days, but did not complete his performance by doing finished carpentry work. Foote, however, never commenced the plumbing work at Lee's house, claiming that Lee prevented him from performing by hiring other plumbers to do the work without giving Foote a reasonable time in which to start the work. The trial court found that the evidence did not support Foote's assertion, and that Foote breached the contract without any legal justification.

Lee sued to recover as damages the reasonable market value of his carpentry services to Foote. In his complaint, Lee sought \$15,000 for the "reasonable market value" of his work and \$5,000 in damages for Foote's failure to perform timely, which Lee claimed caused him "to fall behind in his job completion time table," and costs. In his answer to the complaint, Foote denied "the reasonable market value to the work 'performed' by Plaintiff." The trial court denied Lee the damages he sought on the ground that since the contract terms called for a mutual exchange of services, the proper measure of Lee's damages was the cost to him of hiring other plumbers to perform the work. As Lee failed to introduce any evidence of that cost, the trial court awarded him only nominal damages of one dollar. It is from this legal ruling by the trial court that Lee appeals.

When an express contract has been repudiated or materially breached by the defendant, restitution for the value of the non-breaching party's performance is available as an alternative to an action for damages on the contract. *Ingber v. Ross*, 479 A.2d 1256 (D.C. 1984) (citing 12 WILLISTON ON CONTRACTS § 1454 at 14 (1970)). Restitution for material breach or repudiation of a contract is based upon the principle of unjust enrichment. *TVL Associates v. A&M Construction Corp.*, 474 A.2d 156, 159 (D.C. 1984). The purpose of restitution is to require the wrongdoer to restore what he has received and thereby tend to put the injured party in as good a position as that occupied by him before the contract was made. Restatement (Second) of Contracts § 373 (1981).

Restitution is available in this jurisdiction for partial performance by a plaintiff of services under an express contract which has been breached by a defendant. In *Sterling v. Marshall*, 54 A.2d 353, 356 (D.C. 1947), the plaintiff sued for the value of his engineering services to the defendant pursuant to an express contract. The defendant had breached the contract after partial performance by the plaintiff; this court held that the plaintiff was entitled to recover for the reasonable value of his work. This principle was followed in *Aiken v. United Broadcasting Co.*, 238 A.2d 588, 590 (D.C. 1968), where the plaintiff had agreed to do printing work for the defendant, who in turn agreed to provide the plaintiff with radio advertising. When the defendant failed to perform, the plaintiff sued him for the value of the printing services provided. The court held that

Failure to provide service may result in a money judgment. Where the party from whom payment is due in something other than money, such as goods or other commodities, fails to pay in the particular way specified in the contract, payment in money may be demanded.

Id. at 590.¹ See also 5 CORBIN § 1112 (proper measure of recovery in restitution is the reasonable value of the part performance rendered by the plaintiff to the defendant,

¹ [By the court] Other jurisdictions also allow recovery for partial performance where there is an express contract. See *Oliver v. Campbell*, 273 P.2d 15, 17-18 (Cal. 1954); *Hoefflin v. Wilkerson*, 210 S.W. 667 (Ky. Ct. App. 1919); *Palmer v. Brown*, 40 A.2d 514, 517 (Md. 1945); *Weber v. Billman*, 135 N.E.2d 866, 871 (Ohio 1956); *Goldman v. Shapiro*, 84 A.2d 628, 630 (N.J. Super. Ct. 1951).

uncontrolled by the contract price or rate or by any other terms of the express contract).²

The trial court found there was an express contract between Lee and Foote. It further found that Lee had performed carpentry work for Foote, which Foote had accepted, and that Foote had breached the contract by failing to perform any of the plumbing work he had agreed to render in return for Lee's performance. Despite finding an express contract, the trial court erroneously held as a matter of law that Lee was not entitled to recover for the value of his performance because the express contract called for Foote to render services rather than pay Lee for his performance. Under *Sterling v. Marshall* and *Aiken v. United Broadcasting Co.*, Lee was entitled to recover in restitution for the reasonable value of his part performance.

Because of its ruling denying Lee restitution of the value of his performance, the trial court did not make findings as to the reasonable value of Lee's carpentry work. We are unable to determine on the record before us whether Lee presented sufficient evidence on that issue for the trial court to arrive at a "just and reasonable estimate based on relevant data" of the value of Lee's services. *TVL Associates*, 474 A.2d at 160. Accordingly, we reverse and remand for a new trial limited to proof of the damages to which Lee is entitled as compensation for the reasonable value of the carpentry work which he rendered to Foote.

Review Question 1. The court in *Lee v. Foote* quotes the Restatement (Second) of Contracts § 371 as defining the restitution measure as either (a) the reasonable value of the work measured by how much it would have cost to have it done, or (b) the actual increase in value of the other party's property or interests—depending on what "justice requires." Is there some standard for when "justice" would require one or the other? Or is it just the fact-finder's gut feeling? Didn't we come across this "justice" problem earlier when studying promissory estoppel? What factors might influence which of the two restitution measures is "just" in a given case?

² [By the court] The Restatement (Second) of Contracts provides:

§ 371. Measure of Restitution Interest

If a sum of money is awarded to protect a party's restitution interest, it may as justice requires be measured by either

(a) the reasonable value to the other party of what he received in terms of what it would have cost him to obtain it from a person in the claimant's position, or

(b) the extent to which the other party's property has been increased in value or his other interests advanced.

**UNITED STATES *ex rel.* COASTAL STEEL ERECTORS, INC. v. ALGERNON
BLAIR, INC.**

United States Court of Appeals for the Fourth Circuit
479 F.2d 638 (4th Cir. 1973)

CRAVEN, Circuit Judge:

May a subcontractor, who justifiably ceases work under a contract because of the prime contractor's breach, recover in *quantum meruit* the value of labor and equipment already furnished pursuant to the contract irrespective of whether he would have been entitled to recover in a suit on the contract? We think so, and, for reasons to be stated, the decision of the district court will be reversed.

The subcontractor, Coastal Steel Erectors, Inc., brought this action under the provisions of the Miller Act, 40 U.S.C. § 270a *et seq.*, in the name of the United States against Algernon Blair, Inc., and its surety, United States Fidelity and Guaranty Company.³ Blair had entered a contract with the United States for the construction of a naval hospital in Charleston County, South Carolina. Blair had then contracted with Coastal to perform certain steel erection and supply certain equipment in conjunction with Blair's contract with the United States. Coastal commenced performance of its obligations, supplying its own cranes for handling and placing steel. Blair refused to pay for crane rental, maintaining that it was not obligated to do so under the subcontract. Because of Blair's failure to make payments for crane rental, and after completion of approximately 28 percent of the subcontract, Coastal terminated its performance. Blair then proceeded to complete the job with a new subcontractor. Coastal brought this action to recover for labor and equipment furnished.

The district court found that the subcontract required Blair to pay for crane use and that Blair's refusal to do so was such a material breach as to justify Coastal's terminating performance. This finding is not questioned on appeal. The court then found that under the contract the amount due Coastal, less what had already been paid, totaled approximately \$37,000. Additionally, the court found Coastal would have lost more than \$37,000 if it had completed performance. Holding that any amount due Coastal must be reduced by any loss it would have incurred by complete performance of the contract, the court denied recovery to Coastal. While the district court correctly stated the "normal" rule of contract damages, we think Coastal is entitled to recover in *quantum meruit*.

³ [The Miller Act is a statute that gives subcontractors who are owed money under a government contracts to sue the prime contractor and its surety in federal court. For procedural reasons, such cases are brought in the name of the United States *ex relatione* (roughly, "on behalf of" the subcontractor, although it is actually a dispute between private parties. – Eds.)]

In *United States ex rel. Susi Contracting Co. v. Zara Contracting Co.*, 146 F.2d 606 (2d Cir. 1944), a Miller Act action, the court was faced with a situation similar to that involved here—the prime contractor had unjustifiably breached a subcontract after partial performance by the subcontractor. The court stated:

For it is an accepted principle of contract law, often applied in the case of construction contracts, that the promisee upon breach has the option to forego any suit on the contract and claim only the reasonable value of his performance.

146 F.2d at 610. The Tenth Circuit has also stated that the right to seek recovery under *quantum meruit* in a Miller Act case is clear. *Quantum meruit* recovery is not limited to an action against the prime contractor but may also be brought against the Miller Act surety, as in this case. Further, that the complaint is not clear in regard to the theory of a plaintiff's recovery does not preclude recovery under *quantum meruit*. *Narragansett Improvement Co. v. United States*, 290 F.2d 577 (1st Cir. 1961). A plaintiff may join a claim for *quantum meruit* with a claim for damages from breach of contract.

In the present case, Coastal has, at its own expense, provided Blair with labor and the use of equipment. Blair, who breached the subcontract, has retained these benefits without having fully paid for them. On these facts, Coastal is entitled to restitution in *quantum meruit*.

The “restitution interest,” involving a combination of unjust impoverishment with unjust gain, presents the strongest case for relief. If, following Aristotle, we regard the purpose of justice as the maintenance of an equilibrium of goods among members of society, the restitution interest presents twice as strong a claim to judicial intervention as the reliance interest, since if *A* not only causes *B* to lose one unit but appropriates that unit to himself, the resulting discrepancy between *A* and *B* is not one unit but two.

The impact of *quantum meruit* is to allow a promisee to recover the value of services he gave to the defendant irrespective of whether he would have lost money on the contract and been unable to recover in a suit on the contract. The measure of recovery for *quantum meruit* is the reasonable value of the performance, and recovery is undiminished by any loss which would have been incurred by complete performance. While the contract price may be evidence of reasonable value of the services, it does not measure the value of the performance or limit recovery. Rather, the standard for measuring the reasonable value of the services rendered is the amount for which such services could have been purchased from one in the plaintiff's position at the time and place the services were rendered.

Since the district court has not yet accurately determined the reasonable value of the labor and equipment use furnished by Coastal to Blair, the case must be

remanded for those findings. When the amount has been determined, judgment will be entered in favor of Coastal, less payments already made under the contract.

Review Question 2. The *Algernon Blair* court says that a “plaintiff may join a claim for *quantum meruit* with a claim for damages from breach of contract.” What does the court mean when it refers to a “claim for *quantum meruit*,” and why is that claim not considered a breach of contract claim?

Review Question 3. The subcontractor in *Algernon Blair* apparently made a bad deal and got lucky that the government breached the contract. Why do you think a court would approve a remedy that gives the subcontractor anything at all?

Review Question 4. Parties frequently enter into contracts with a profit motive, hoping to end up richer than before as a result of the contract. Indeed, the law of contracts greatly facilitates such business dealings. If you were a judge, what rule would you articulate as to what kind of enrichment is “unjust” rather than socially-beneficial profit seeking?

B. Reliance

SULLIVAN v. O’CONNOR

Supreme Judicial Court of Massachusetts
363 Mass. 579, 296 N.E.2d 183 (1973)

The plaintiff patient secured a jury verdict of \$13,500 against the defendant surgeon for breach of contract in respect to an operation upon the plaintiff’s nose. The declaration was in two counts. In the first count, the plaintiff alleged that she, as patient, entered into a contract with the defendant, a surgeon, wherein the defendant promised to perform plastic surgery on her nose and thereby to enhance her beauty and improve her appearance; that he performed the surgery but failed to achieve the promised result; rather the result of the surgery was to disfigure and deform her nose, to cause her pain in body and mind, and to subject her to other damage and expense. The second count, based on the same transaction, was in the conventional form for malpractice, charging that the defendant had been guilty of negligence in performing the surgery. Answering, the defendant entered a general denial.

On the plaintiff’s demand, the case was tried by jury. At the close of the evidence, the judge put to the jury, as special questions, the issues of liability under

the two counts, and instructed them accordingly. The jury returned a verdict for the plaintiff on the contract count, and for the defendant on the negligence count.

[Discussion of the negligence count is omitted.]

As background, we mention certain facts as the jury could find them. The plaintiff was a professional entertainer and this was known to the defendant. The agreement was as alleged in the declaration. More particularly, judging from exhibits, the plaintiff's nose had been straight, but long and prominent; the defendant undertook by two operations to reduce its prominence and somewhat to shorten it, thus making it more pleasing in relation to the plaintiff's other features. Actually the plaintiff was obliged to undergo three operations, and her appearance was worsened. Her nose now had a concave line to about the midpoint, at which it became bulbous; viewed frontally, the nose from bridge to midpoint was flattened and broadened, and the two sides of the tip had lost symmetry. This configuration evidently could not be improved by further surgery. The plaintiff did not demonstrate, however, that her change of appearance had resulted in loss of employment. Payments by the plaintiff covering the defendant's fee and hospital expenses were stipulated at \$622.65.

If an action on the basis of contract is allowed, we have the question of the measure of damages to be applied where liability is found. Some cases have taken the simple view that the promise by the physician is to be treated like an ordinary commercial promise, and accordingly that the successful plaintiff is entitled to a standard measure of recovery for breach of contract, "compensatory" ("expectancy") damages, an amount intended to put the plaintiff in the position he would be in if the contract had been performed, or, presumably, at the plaintiff's election, "restitution" damages, an amount corresponding to any benefit conferred by the plaintiff upon the defendant in the performance of the contract disrupted by the defendant's breach. Thus in *Hawkins v. McGee*, 146 A. 641 (N.H. 1929), the court, following the usual expectancy formula, would have asked the jury to estimate and award to the plaintiff the difference between the value of a good or perfect hand, as promised, and the value of the hand after the operation. If the plaintiff had not yet paid the doctor his fee, that amount would be deducted from the recovery. There could be no recovery for the pain and suffering of the operation, since that detriment would have been incurred even if the operation had been successful; one can say that this detriment was not "caused" by the breach. But where the plaintiff by reason of the operation was put to more pain than he would have had to endure, had the doctor performed as promised, he should be compensated for that difference as a proper part of his expectancy recovery. The New Hampshire court further refined the *Hawkins* analysis in *McQuaid v. Michou*, 85 N. H. 299, all in the direction of treating the patient-physician cases on the ordinary footing of expectancy. See *McGee v. United States Fid. & Guar. Co.* 53 F.2d 953 (1st Cir. 1931) (later development in the *Hawkins* case).

Other cases, including a number in New York, without distinctly repudiating the *Hawkins* type of analysis, have indicated that a different and generally more

lenient measure of damages is to be applied in patient-physician actions based on breach of alleged special agreements to effect a cure, attain a stated result, or employ a given medical method. This measure is expressed in somewhat variant ways, but the substance is that the plaintiff is to recover any expenditures made by him and for other detriment (usually not specifically described in the opinions) following proximately and foreseeably upon the defendant's failure to carry out his promise. This, be it noted, is not a "restitution" measure, for it is not limited to restoration of the benefit conferred on the defendant (the fee paid) but includes other expenditures, for example, amounts paid for medicine and nurses; so also it would seem according to its logic to take in damages for any worsening of the plaintiff's condition due to the breach. Nor is it an "expectancy" measure, for it does not appear to contemplate recovery of the whole difference in value between the condition as promised and the condition actually resulting from the treatment. Rather the tendency of the formulation is to put the plaintiff back in the position he occupied just before the parties entered upon the agreement, to compensate him for the detriments he suffered in reliance upon the agreement. This kind of intermediate pattern of recovery for breach of contract is discussed in the suggestive article by Fuller and Perdue, *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 373, where the authors show that, although not attaining the currency of the standard measures, a "reliance" measure has for special reasons been applied by the courts in a variety of settings, including noncommercial settings.

For breach of the patient-physician agreements under consideration, a recovery limited to restitution seems plainly too meager, if the agreements are to be enforced at all. On the other hand, an expectancy recovery may well be excessive. The factors, already mentioned, which have made the cause of action somewhat suspect, also suggest moderation as to the breadth of the recovery that should be permitted. Where, as in the case at bar and in a number of the reported cases, the doctor has been absolved of negligence by the trier, an expectancy measure may be thought harsh. We should recall here that the fee paid by the patient to the doctor for the alleged promise would usually be quite disproportionate to the putative expectancy recovery. To attempt, moreover, to put a value on the condition that would or might have resulted, had the treatment succeeded as promised, may sometimes put an exceptional strain on the imagination of the fact finder. As a general consideration, Fuller and Perdue argue that the reasons for granting damages for broken promises to the extent of the expectancy are at their strongest when the promises are made in a business context, when they have to do with the production or distribution of goods or the allocation of functions in the market place; they become weaker as the context shifts from a commercial to a noncommercial field. There is much to be said, then, for applying a reliance measure to the present facts, and we have only to add that our cases are not unreceptive to the use of that formula in special situations. Suffering or distress resulting from the breach going beyond that which was envisaged by the

treatment as agreed, should be compensable on the same ground as the worsening of the patient's conditions because of the breach. Indeed it can be argued that the very suffering or distress "contracted for"—that which would have been incurred if the treatment achieved the promised result—should also be compensable on the theory underlying the New York cases. For that suffering is "wasted" if the treatment fails. Otherwise stated, compensation for this waste is arguably required in order to complete the restoration of the status quo ante.

In the light of the foregoing discussion, the plaintiff was not confined to the recovery of her out-of-pocket expenditures; she was entitled to recover also for the worsening of her condition, and for the pain and suffering and mental distress involved in the third operation. These items were compensable on either an expectancy or a reliance view. We might have been required to elect between the two views if the pain and suffering connected with the first two operations contemplated by the agreement, or the whole difference in value between the present and the promised conditions, were being claimed as elements of damage. But the plaintiff waives her possible claim to the former element, and to so much of the latter as represents the difference in value between the promised condition and the condition before the operations.

Review Question 5. Note the court's statements that an expectancy measure "may be thought harsh." Presumably the doctor would think it harsh, but would the patient? Would you? What argument, if any, does the court make to suggest that there is some sort of unfairness in enforcing expectancy in this kind of situation?

Review Question 6. Do you agree with the court that plastic surgery (and healthcare in general) is a "noncommercial" field? If so, should that make a difference? Should promises made by your plastic surgeon be treated differently than those made by your hair stylist?

MISTLETOE EXPRESS SERVICE OF OKLAHOMA CITY v. LOCKE

Court of Appeals of Texas, Sixth District
762 S.W.2d 637 (Tex. App.—Texarkana 1988)

CORNELIUS, J.

Mistletoe Express Service appeals from an adverse judgment in a breach of contract suit.

Phyllis Locke, doing business as Paris Freight Company, entered into a contract with Mistletoe on October 18, 1984, which provided that Locke would perform a pickup and delivery service for Mistletoe at various locations in Texas. The contract term was one year from October 1, 1984. At the expiration of the initial term, the agreement would continue on a month-to-month basis until either party terminated it by thirty-day written notice.

In order to perform her contract, it was necessary for Locke to make certain investments and expenditures. In uncontroverted testimony, she stated that she spent \$3,500 for materials to build a steel and pipe ramp and \$1,000 for dirt work. She also borrowed \$15,000, with which she purchased two vehicles for \$ 9,000 and paid \$ 6,000 for starting-up expenses. She testified that she would not have done any of these things had she not made the contract with Mistletoe. Locke's company never made a profit, although the losses decreased each month while the contract was in force.

On May 15, 1985, Mistletoe notified Locke that it planned to cancel the contract effective June 15, 1985. Locke closed her business and sold the vehicles for \$6,000, taking a loss of \$3,000. At the time of trial, Locke still owed \$9,750 on her \$15,000 loan, and had paid \$2,650 in interest. She testified that the customized ramp was worth \$500 as scrap. She considered the \$1,000.00 expended for dirt work a lost expense.

The jury found Locke's damages at \$19,400.00. The court entered judgment for that amount, plus prejudgment interest and attorney's fees of \$ 2,000.

Mistletoe's sole contention is that the trial court should have granted it a directed verdict or judgment notwithstanding the verdict, because there is no evidence to support the damages which the jury awarded. The gist of the argument is that the victim of a contract breach is only entitled to be placed in the position he would have been in had the contract been performed, and therefore Locke could only recover the profits she lost by reason of the breach.

It is a general rule that the victim of a breach of contract should be restored to the position he would have been in had the contract been performed. Determining that position involves finding what additions to the injured party's wealth have been prevented by the breach and what subtractions from his wealth have been caused by it. 5 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 992 (1964). Where the contract requires a capital investment by one of the parties in order to perform, that party's reasonable expectation of profit includes recouping the capital investment. The expending party would not be in as good a position as if the contract had been performed if he is not afforded the opportunity, *i.e.*, the full contract term, to recoup his investment. *Houston Chronicle Publishing Co. v. McNair Trucklease, Inc.*, 519 S.W.2d 924 (Tex. Civ. App. 1975). To recover these expenditures they must have been reasonably made in performance of the contract or in necessary preparation.

The Restatement (Second) of Contracts § 349 (1981) states:

As an alternative to [expectation damages], the injured party has a right to damages based on his reliance interest, including expenditures made in preparation for performance or in performance, less any loss that the party in breach can prove with reasonable certainty the injured party would have suffered had the contract been performed.

Further, in section 349, comment a, the authors of the Restatement state:

Under the rule stated in this Section, the injured party may, if he chooses, ignore the element of profit and *recover as damages his expenditures in reliance*. He may choose to do this . . . in the case of a *losing contract*, one under which he would have had a loss rather than a profit. In that case, however, it is *open to the party in breach to prove* the amount of the loss, to the extent that he can do so with reasonable certainty under the standard stated in section 352, and have it subtracted from the injured party's damages.

(Emphasis added.)

Under these rules, Locke is entitled to the expenditures she incurred in order to perform her contract. Her uncontradicted testimony and exhibits prove the amounts of these damages.

Mistletoe's argument that Locke must show what her position would have been at the earliest time the contract could legally have been terminated is misplaced. Under the cited rules, she can recover her reliance expenditures because she was deprived of an opportunity to recoup those expenditures. Moreover, Mistletoe is not entitled to have Locke's losses deducted from the recovery, because Mistletoe had the burden to prove that amount, if any, and it did not do so. Restatement (Second) of Contracts § 349 cmt a.

There is no evidence, however, to support an award of \$19,400.00. That figure includes both the loss from the resale of the vehicles which were purchased with the loan and the current balance of the loan. Locke's reliance damages were the amount of the loan (\$15,000), less the amount recovered from the sale of the property purchased with the loan (\$6,000). The resulting \$9,000 should be added to the cost of the dirt work (\$1,000) and the loss from the materials for the ramp (\$3,000). Furthermore, Locke would be receiving a double recovery also if she recovers the full amount of the interest paid on the loan as well as the prejudgment interest allowed by the judgment.

For the reasons stated, the judgment of the trial court is reformed to award Locke damages in the sum of \$13,000, plus prejudgment interest thereon for 910 days, plus attorney's fees of \$2,000.00, as awarded in the original judgment. As reformed, the judgment of the trial court is affirmed.

Review Question 7. Note the parallel between *Mistletoe Express* and *Algernon Blair*. Both cases involved parties who were losing money on contracts and actually came out better because of the breach. But the *Algernon Blair* plaintiff sought restitution damages while the plaintiff in *Mistletoe Express* sought reliance. Think about why each chose that measure, and try to explain why both parties had really good lawyers.

Review Question 8. On the basis of this and the following case, can you articulate the standard for calculating what elements of expense should be considered as reliance damages? Are courts doing anything more than throwing things at the wall to see what sticks? If so, what are they doing?

DOERING EQUIPMENT CO. v. JOHN DEERE CO.

Appeals Court of Massachusetts

61 Mass. App. Ct. 850, 815 N.E.2d 234 (Mass. Ct. App. 2004)

KAFKER, J.

Doering Equipment Company (Doering) had lost money every year on its contract to act as a distributor for John Deere Co. (Deere) golf and turf products. When Deere insisted that Doering purchase a large number of “turf gators,” a new multi-purpose utility vehicle that Doering thought would sell poorly, Doering terminated the contract and sought to recover its losses incurred during the previous three years. It claimed that the demand that it purchase the turf gators breached the covenant of good faith and fair dealing.

Doering brought suit against Deere, seeking recovery of approximately \$500,000, consisting of its operating losses for its golf and turf business over the last three years (\$139,865 in 1996; \$150,720 in 1995; and \$172,783 in 1994) and attorney’s fees. Doering did not seek recovery for lost profits. Deere counterclaimed for monies previously owed.

[The trial judge granted summary judgment for Deere on most claims and prohibited Doering from introducing evidence of its alleged reliance damages—its losses in performing the contract for the previous three years—on its remaining claims. The court also granted Deere \$118,467.34 plus attorney’s fees of \$70,000 on its counterclaims for goods received and not paid for.]

Doering has consistently sought to recover all its operating losses, but its theory of recovery has an elusive, chameleon-like quality. On appeal, Doering appears

to have settled generally on a reliance theory of damages. It also identifies the turf gator demand as the breach or unfair trade practice for which it seeks recovery. The relationship between the breach and the damages, however, is unclear.

As the trial judge recognized, there appears to be no causal connection between the prior years' losses and the demand that Doering purchase the turf gators. See, e.g., *Massachusetts Farm Bureau Federation, Inc. v. Blue Cross of Massachusetts, Inc.*, 532 N.E.2d 660 (Mass. 1989) ("In the absence of a causal relationship between the alleged unfair acts and the claimed loss, there can be no recovery"). See *VMark Software, Inc. v. EMC Corp.*, 642 N.E.2d 587 (Mass. App. Ct. 1994) (measure of contract reliance damages is "similar to the tort standard of actual, or out-of-pocket, loss proximately suffered"). See also *Sullivan v. O'Connor*, 296 N.E.2d 183 (Mass. 1973). The damages sought had been sustained while the contract was being performed according to its terms, before the turf gator demand was made. According to the damages figures submitted by Doering, the agreement was a losing proposition from the outset. The damages were, therefore, caused by the bad bargain itself, not the October breach. The breach may have led Doering to terminate the contract, but it did not cause the contract losses, which Doering had already incurred.

Doering seems to recognize the unfavorable nature of the bargain as it makes no argument that the breach prevented it from continuing the contract and recouping the accrued losses. See *Mistletoe Express Serv. v. Locke*, 762 S.W.2d 637, 638 (Tex. App. 1988). Doering also has not generally argued that the breach deprived it of the benefit of the bargain. See *Anthony's Pier Four, Inc. v. HBC Associates*, 583 N.E.2d 806 (1991); *VMark Software*, 642 N.E.2d at 590 n.2 ("the long-established general rule for breach of contract recovery in Massachusetts is that the wronged party should receive the benefit of his bargain, i.e., be placed in the same position as if the contract had been performed"). See also Restatement (Second) of Contracts § 347 (1981) ("Contract damages are ordinarily based on the injured party's expectation interest and are intended to give him the benefit of his bargain by awarding him a sum of money that will, to the extent possible, put him in as good a position as he would have been in had the contract been performed").

Relying on *VMark Software* and Restatement section 349, Doering contends instead that it is entitled to recover its operating losses for the three years prior to the "constructive termination" of the contract as "reliance" damages. As this court stated in *VMark*, "in an appropriate case, Massachusetts law permits, as an alternative to such 'expectation' damages, the recovery of 'reliance' damages, i.e., expenditures made in reliance upon a contractual obligation that was not performed." *VMark*, 42 N.E.2d at 590 n.2. See *Sullivan v. O'Connor*, 296 N.E.2d at 186-88; *Lord's & Lady's Enterprises, Inc. v. John Paul Mitchell Systems*, 705 N.E.2d 302 (Mass. App. Ct. 1999).

In *VMark*, unlike this case, there was a direct causal connection between the expenditures sought by the injured party as reliance damages, and the contractual

obligations that were not performed. There, the injured party purchased computer hardware from a third company in “reliance on VMark’s supplying it with a software product that would be fully functional in conjunction with that hardware.” We concluded that the hardware would not have been purchased “but for VMark’s misleading representations.” Here, in contrast, the motion judge, in allowing summary judgment, rejected Doering’s contention that it could prove that it entered into the contract and incurred the expenses based on various misrepresentations. Doering does not challenge this decision on appeal. The lack of a causal connection between the claimed breach (or unfair act) and the losses is fatal to Doering’s claims.

Furthermore, as provided in the Restatement (Second) of Contracts § 349, the “injured party has a right to damages based on his reliance interest, including expenditures made in preparation for performance or in performance,” but “less any loss that the party in breach can prove with reasonable certainty the injured party would have suffered had the contract been performed.” See *L. Albert & Son v. Armstrong Rubber Co.*, 178 F.2d 182, 189 (2d Cir. 1949) (where Hand, J., writing for the court, stated, “on principle therefore the proper solution would seem to be that the promisee may recover his outlay in preparation for the performance, subject to the privilege of the promisor to reduce it by as much as he can show that the promisee would have lost, if the contract had been performed”).⁴ In the instant case, Doering is seeking to recover expenditures made in preparation for performance or during performance, but has also demonstrated, through its own submissions, that the contract, as performed, had been a losing proposition since inception, separate and apart from the breach. In fact, the operating losses for the contract, while being performed by both parties, are exactly what Doering seeks to recover. We are, therefore, in the rare position of being able to judge with accuracy “what the fate of the venture would have been had it not been interrupted” by the defendant’s breach. Fuller & Perdue, *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 79 (1936).

If Doering recovered its losses as requested, it would be in a better position than if the contract had been performed. This would violate the fundamental principle first articulated by Professor Fuller and thereafter adopted by Judge Learned Hand in *Albert & Son*, the Restatement (Second), and this court in *Lord’s & Lady’s Enterprises*, that “we will not in a suit for reimbursement for losses incurred in reliance on a contract knowingly put the plaintiff in a better position than he would have [been in] . . . had the contract been fully performed.” Fuller & Perdue, 46 YALE

⁴ [By the court] We recognize that a “party standing in breach cannot insist on mathematical precision in the measurement of damages, and may expect some lack of sympathy when he claims that the loss would have been suffered even if breach had not occurred.” *Gilmore v. Century Bank & Trust Co.*, 477 N.E.2d 1069 (Mass. App. Ct. 1985). Therefore, the burden is placed on the breaching party to establish the losses with “reasonable certainty.” Restatement (Second) of Contracts § 349.

L.J. at 79. See *Productora e Importadora de Papel v. Fleming*, 383 N.E.2d 1129 (Mass. 1978) (damage award “should be reduced, even to extinction, by the expenses that the breach” allowed the injured party to avoid).

Judgment affirmed.

Review Question 9. *Doering* and *Mistletoe Express* both involve situations in which one party has reasonably relied on performance from its counterparty. But the plaintiff in *Mistletoe Express* wins and the plaintiff in *Doering* loses. What, if any, is the factual difference between the two cases that leads to a different result?

Review Question 10. As a contract litigator, in what kinds of situations would you be likely to pursue reliance (rather than expectancy or restitution) as your preferred measure of damages? Under what factual conditions would you expect parties to prefer to seek reliance damages?

Problems

Problem 24.1

Titus, a wealthy oil magnate, is a huge fan of Gram Parsons, the influential musician who co-founded the Flying Burrito Brothers and who died at age 26 of a drug and alcohol overdose in 1973. He has an extensive collection of Parsons memorabilia and other materials related to the Los Angeles country-rock scene in the period 1965-75. Titus really wants the turquoise 1960 Ford Galaxie convertible that Parsons owned when he moved to Los Angeles in 1966, and which has marijuana decals and cigarette burns inflicted by Parsons. The car is now owned by a distant cousin of Parsons, Elmer. Titus and Elmer sign a contract in which Elmer will sell the car to Titus for \$1 million. The car, which is currently loaned on display at the Country Music Museum in Del Ray, Florida, will be delivered in three months, on July 15. Titus puts \$50,000 down on the car.

Titus immediately begins renovations to his palatial Houston home, widening the living room and opening it into a gallery of his collection. Architects design a special lighted platform on which the car will be displayed; the car will effectively be the centerpiece of his home. The renovations necessary to accommodate the car are done at a total cost of \$200,000.

Three days before the car is due to be delivered, Elmer calls Titus and informs him that he has decided that the car is better off in a museum, and so he has sold the

car to the Country Music Museum for \$1,000,001. Elmer returns Titus's check. Titus subsequently sues Elmer. As the car has already been conveyed to the Museum, Titus's only remedy is damages. What damages can he collect from Elmer? Work through each of the three categories. Which one would he be advised to seek?

Expectancy damages: _____

Restitution damages: _____

Reliance damages: _____

Problem 24.2

Back in Unit 9, which covered promissory estoppel, you read the case of *Hoffman v. Red Owl Stores, Inc.* There, Joseph Hoffman had extensive, multi-year negotiations about obtaining a Red Owl grocery store franchise. The two sides never signed a final contract, but Hoffman sold his bakery, bought a small grocery store to gain experience, and engaged in other transactions in the midst of representations made by Red Owl during the negotiations. Hoffman never received a Red Owl franchise, and he sued Red Owl. While the parties had no contract, the Wisconsin Supreme Court held that Hoffman could recover based on promissory estoppel. With regard to damages, the court said "it would be a mistake to regard an action grounded on promissory estoppel as the equivalent of a breach of contract action" that allowed for recovery of expectancy damages. Instead damages must be based on reliance, and even reliance damages could be allowed only to the extent that injustice could be avoided. The case was then remanded to the trial court for a new trial on the issue of damages.

You are a clerk working for the trial judge in *Hoffman* upon its remand. Assume for purposes of this problem that Hoffman is seeking from Red Owl Stores the categories of damages listed below (which, incidentally, are not the same as those in the real-life case). The judge has asked you to determine whether each type of qualifies as expectancy, restitution, or reliance damages, given that only reliance damages will likely be recoverable. If you think you need more information to answer any of the questions, you should identify the information.

(a) Expected future profits from Hoffman's bakery, which he sold upon the recommendation of Red Owl.

(b) Purchase price of real estate on which to build Hoffman's expected Red Owl franchise, but Hoffman still owns the lot.

(c) Losses incurred when Hoffman sold the equipment and fixtures from his small "starter" grocery store below cost based on Red Owl's statement that it was about to grant him a Red Owl franchise.

(d) Rental costs of an additional \$150 per month incurred when Hoffman moved his family 100 miles to be closer to the location of his expected Red Owl franchise.

(e) \$1,000 paid to Red Owl as a nonrefundable "Franchisee Consideration Fee" at the time Hoffman and Red Owl commenced their negotiations.

(f) Anticipated profits from Hoffman's operation of a Red Owl grocery store.

(g) \$250 loan commitment fee paid by Hoffman to First State Bank in connection with obtaining approval for a loan that was intended to be paid to Red Owl as the "Franchise Fee" at the time Red Owl granted the franchise.

Problem 24.3

In the immediately preceding unit (UNIT 23: THE EXPECTANCY INTEREST), the *Hawkins v. McGee* court found the following jury instruction on damages to be erroneous:

"If you find the plaintiff entitled to anything, he is entitled to recover for what pain and suffering he has been made to endure and what injury he has sustained over and above the injury that he had before." [By] this instruction..., the jury was permitted to consider two elements of damage, (1) pain and suffering due to the operation, and (2) positive ill effects of the operation upon the plaintiff's hand.

The damages instruction was in error, said the *Hawkins* court, because it did not measure George Hawkins's expectation damages from the surgery on his hand. What should this jury instruction say in a jurisdiction where only **reliance** damages were available? What should the jury instruction say if only **restitution** damages were available?

Unit 25: Limits on Damages

REMEDIES

Part Three

FOCUS OF THIS UNIT

In evaluating the principal measures of damages in American contract law—expectancy, reliance, and restitution—we first focused on the general methods of calculating the damages in each category. Much of the initial dispute among contracting parties regarding those calculations relates to valuation of items that parties agree, at least in principle, should be part of the damages formulation. Outside of valuation, however, American contract law sets limits on the means and methods by which parties can prove damages. Particularly with expectancy damages, where contract law is necessarily imagining an alternative future without a contract breach, it should come as no surprise that courts will let imaginations run only so far. A party seeking to prove its claim must work around three important limits on its ability to recover damages. The limitations of *foreseeability*, *avoidability*, and *certainty* are the subject of this unit.

Foreseeability. Today’s concept that contract damages must be foreseeable to the breaching party in order to be recoverable by the non-breaching party traces back to the famous English case of *Hadley v. Baxendale*, 156 Eng. Rep. 145 (Ex. Ch. 1854). In *Hadley*, plaintiffs owned a flour mill that went out of service because of a break in the crankshaft that worked the mill. Through neglect by the defendant delivery service, a needed replacement part arrived five days late, and plaintiffs sought to recover their loss of five days of output by the mill. The court declined to award those damages because they could not “reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.” More than 160 years later, American contract law prohibits the awarding of damages that were not foreseeable to both parties at the time of contracting. The *Hadley* rule shows up in many places, including in section 351 of the Restatement (Second) of Contracts and in Article 74 of the CISG.

Avoidability and the “Duty to Mitigate.” Once a contracting party knows that it is the victim of a breach, is it allowed to do nothing and let its damages award keep ticking upward? The general answer to this question is no. Section 350 of the Restatement (Second) of Contracts states the typical rule: If a non-breaching party can avoid breach-of-contract damages “without undue risk, burden, or humiliation,”

but fails to do so, it will not be awarded those damages. Lawyers and courts sometimes refer to this concept as the “duty to mitigate,” but you should understand that this is not a “duty” in the sense of being an affirmative obligation such as the duty of ordinary care in negligence law. A party is free to not mitigate its damages, but the cost of it doing so is that it will not be awarded those damages it could have avoided.

Certainty. Our final limiting doctrine is very easy to state but somewhat challenging to apply. Section 352 of the Restatement (Second) of Contracts provides that “[d]amages are not recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty.” What exactly does “reasonable certainty” mean? Where buyer Burge’s new business venture suffers because of seller Snyder’s contract breach, proving expectancy damages can be quite difficult because of the certainty test. Burge might claim that his line of collectable law professor figurines would have generated enormous profits if only Snyder had delivered the rare marble required to make them. Can Burge prove his claim in a way that rises above the level of pure (and self-interested) speculation? Application of this test ends up being very fact specific and allows for a great deal of creative advocacy by lawyers.

Cases and Materials

A. The Foreseeability Limitation

SOUTHERN ILLINOIS RIVERBOAT/CASINO CRUISES, INC. v. HNEKAK BOBO GROUP, INC.

United States District Court for the Southern District of Illinois
2007 U.S. Dist. LEXIS 53776 (No. 03-CV-4215-JPG)

GILBERT, U.S.D.J.

This matter comes before the Court on a motion for partial summary judgment on the issue of liability for plaintiff’s fire watch expenses filed by defendant Hnekak Bobo Group, Inc. (“HBG”). The plaintiff, Southern Illinois Riverboat/Casino Cruises, Inc. (“Harras”), has responded to HBG’s motion and HBG has replied to the response.

Harras and HBG entered into an agreement on June 29, 2000, under which HBG agreed to design the docking facility for a riverboat casino Harras planned to build on the Ohio River in Metropolis, Illinois. Harras wanted to replace the casino it was operating on the site because it was in very poor condition. The parties’ contract

(the Agreement) contained several provisions dealing with code compliance. Among other things, HBG agreed to assist Harrahs “in the filing of the required documents for the approval of governmental authorities having jurisdiction over the Project” and to revise “the drawings, if necessary for such approval.” The Agreement also provides that, “Prior to the commencement of construction, [HBG] shall provide documentation to [Harrahs] that, in the professional judgment of [HBG], all plans specifications and drawings conform to all applicable governmental regulations, statutes and ordinances, and the improvements when built in accordance therewith will conform to applicable regulations.”

Pursuant to the Agreement, HBG designed a dock with four ramps providing access to the riverboat. HBG eventually determined, after employing an independent code consultant, that a cheaper, two-ramp design would satisfy the applicable codes and regulations. Upon review, Harrahs agreed to the two-ramp design. On March 23, 2000, HBG, its code consultant, and Harrahs met with a representative of the State Fire Marshal to review the two-ramp plan. The Fire Marshal’s representative orally confirmed that the two-ramp plan complied with applicable fire code. He declined, however, to provide written approval of the design because it was his policy to withhold such approval until he conducted an inspection of a completed facility.

HBG completed the dock in August 2001. On August 6, 2001, Harrahs moved the old boat to the new dock and continued operating the old boat there until the new boat arrived. The Fire Marshal inspected the old boat/new dock facility on August 24, 2001, and concluded that it failed to meet code because of ingress and egress problems. The Fire Marshal refused to certify the structure and told Harrahs it had to maintain a fire watch if it intended to continue its operations. Harrahs chose to keep the facility open and to maintain the fire watch.¹

Once the new boat arrived on September 10, 2001 and its connection to the new dock was complete, the Fire Marshal inspected the set up and concluded that the facility needed additional ramps to comply with code. He concluded that the casino could not remain open unless Harrahs continued to maintain a fire watch. After an abortive appeal, Harrahs decided to build a third ramp. HBG claims Harrahs asked it and Thompson to submit plans for building the third ramp. HBG claims Harrahs chose to go with Thompson and fired HBG. Harrahs, on the other hand, contends that HBG continued to be involved with the third ramp until its completion.

Harrahs brings the instant action against HBG, alleging that it breached both express and implied warranties by submitting a plan for the dock that did not comply with applicable code.

¹ [By the court] Because of the code violations, Harrahs had to pay local firefighters to keep a fire watch on the boat 24 hours a day until it attained compliance with applicable codes.

HBG [argues that] summary judgment [should be granted] on the issue of damages for fire watch expenses [because] Harrahs cannot recover pursuant to the rule of *Hadley v. Baxendale*, 156 Eng. Rep. 145.

Citing *Hadley*, HBG claims it cannot be liable for the fire watch damages because the parties never contemplated that Harrahs would “open early.” It further contends that the Agreement specifically addressed how the parties would act if the casino failed to obtain the necessary permits: HBG was to redesign the dock and assist Harrahs in obtaining the proper permits. Harrahs, on the other hand, argues that the fire watches are common in the industry, making them at least foreseeable, if not within the contemplation of the parties. In support of this proposition, Harrahs notes that the Office of the State Fire Marshal (OSFM) can require a fire watch when a particular building does not meet the applicable codes. HBG’s code consultant, Jeff Boyle, testified at his deposition that he was aware that a fire watch is a possible course of action for a fire marshal to take in the face of code problems.

The Supreme Court of Illinois has adopted the following rule from *Hadley*:

Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, *i.e.*, according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.

Midland Hotel Corp. v. Reuben H. Donnelley Corp., 515 N.E.2d 61, 67 (Ill. 1987).

Given the testimony of Boyle and others, it certainly appears that fire watch damages were foreseeable. While it is true that HBG had an obligation under the Agreement to redesign the dock if it did not comply with the applicable codes, it does not necessarily follow that the Agreement prohibited Harrahs from mitigating any damages it might suffer as a result of noncompliance. Similarly, even if the parties did not contemplate the need for a fire watch, this does not necessarily mean it was not foreseeable. If it were foreseeable, then whether it was in the specific contemplation of the parties is not particularly relevant. *See Midland Hotel Corp.*, 515 N.E.2d at 67.

The Court DENIES HBG’s motion for partial summary judgment on the issue of fire watch damages.

Review Question 1. Why does contract law require that harm be “foreseeable” if the plaintiff is to recover damages where there is no doubt as to the cause of those damages? Would modern contract law be better served by a different approach?

B. The Avoidability Limitation

ROCKINGHAM COUNTY v. LUTEN BRIDGE CO.

Circuit Court of Appeals, Fourth Circuit
35 F.2d 301 (4th Cir. 1929)

PARKER, Circuit Judge.

This was an action at law instituted in the court below by the Luten Bridge Company, as plaintiff, to recover of Rockingham County, North Carolina, an amount alleged to be due under a contract for the construction of a bridge.

On January 7, 1924, the board of commissioners of Rockingham County voted to award to plaintiff a contract for the construction of the bridge in controversy. Three of the five commissioners favored the awarding of the contract and two opposed it. Much feeling was engendered over the matter, with the result that on February 11, 1924, W.K. Pruitt, one of the commissioners who had voted in the affirmative, sent his resignation to the clerk of the superior court of the County. The clerk proceeded on the next day to appoint one W.W. Hampton as a member of the board to succeed him.²

At a regularly advertised called meeting held on February 21, a resolution was unanimously adopted declaring that the contract for the building of the bridge was not legal and valid, and directing the clerk of the board to notify plaintiff that it refused to recognize same as a valid contract, and that plaintiff should proceed no further thereunder. This resolution also rescinded action of the board theretofore taken looking to the construction of a hard-surfaced road, in which the bridge was to be a mere connecting link. The clerk duly sent a certified copy of this resolution to plaintiff.

At the regular monthly meeting of the board on March 3, a resolution was passed directing that plaintiff be notified that any work done on the bridge would be done by it at its own risk and hazard, that the board was of the opinion that the contract for the construction of the bridge was not valid and legal, and that, even if the board were mistaken as to this, it did not desire to construct the bridge, and would contest payment for same if constructed. A copy of this resolution was also sent to plaintiff.

² [Under North Carolina law at the time, the county clerk had authority to appoint a successor to any commissioner who had died or left office.—Eds.]

On November 24, 1924, plaintiff instituted this action against Rockingham County.

On December 1, 1924, the newly elected board of commissioners held its first meeting and employed attorneys to defend the action which had been instituted by plaintiff against the County. [The County's] answer denied that the contract sued on was legal or binding, and for a further defense set forth the resolutions of the commissioners with regard to the building of the bridge, to which we have referred, and their communication to plaintiff.

At the trial, the jury was instructed to return a verdict for plaintiff for the full amount of its claim.

As the County now admits the execution and validity of the contract, and the breach on its part, the ultimate question in the case is one as to the measure of plaintiff's recovery.

We do not think that, after the County had given notice, while the contract was still executory, that it did not desire the bridge built and would not pay for it, plaintiff could proceed to build it and recover the contract price. It is true that the County had no right to rescind the contract, and the notice given plaintiff amounted to a breach on its part; but, after plaintiff had received notice of the breach, it was its duty to do nothing to increase the damages flowing therefrom. If A enters into a binding contract to build a house for B, B, of course, has no right to rescind the contract without A's consent. But if, before the house is built, he decides that he does not want it, and notifies A to that effect, A has no right to proceed with the building and thus pile up damages. His remedy is to treat the contract as broken when he receives the notice, and sue for the recovery of such damages, as he may have sustained from the breach, including any profit which he would have realized upon performance, as well as any other losses which may have resulted to him. In the case at bar, the County decided not to build the road of which the bridge was to be a part, and did not build it. The bridge, built in the midst of the forest, is of no value to the County because of this change of circumstances. When, therefore, the County gave notice to the plaintiff that it would not proceed with the project, plaintiff should have desisted from further work. It had no right thus to pile up damages by proceeding with the erection of a useless bridge.

The contrary view was expressed by Lord Cockburn in *Frost v. Knight*, L. R. 7 Ex. 111, but, as pointed out by Prof. Williston, it is not in harmony with the decisions in this country. The American rule and the reasons supporting it are well stated by Prof. Williston as follows:

There is a line of cases running back to 1845 which holds that, after an absolute repudiation or refusal to perform by one party to a contract, the other party cannot continue to perform and recover

damages based on full performance. This rule is only a particular application of the general rule of damages that a plaintiff cannot hold a defendant liable for damages which need not have been incurred; or, as it is often stated, the plaintiff must, so far as he can without loss to himself, mitigate the damages caused by the defendant's wrongful act. The application of this rule to the matter in question is obvious. If a man engages to have work done, and afterwards repudiates his contract before the work has been begun or when it had been only partially done, it is inflicting damage on the defendant without benefit to the plaintiff to allow the latter to insist on proceeding with the contract. The work may be useless to the defendant, and yet he would be forced to pay the full contract price. On the other hand, the plaintiff is interested only in the profit he will make out of the contract. If he receives this it is equally advantageous for him to use his time otherwise.

3 WILLISTON ON CONTRACTS 2347.

The leading case on the subject in this country is the New York case of *Clark v. Marsiglia*, 1 Denio (N. Y.) 317. In that case defendant had employed plaintiff to paint certain pictures for him, but countermanded the order before the work was finished. Plaintiff, however, went on and completed the work and sued for the contract price. In reversing a judgment for plaintiff, the court said:

The defendant, by requiring the plaintiff to stop work upon the paintings, violated his contract, and thereby incurred a liability to pay such damages as the plaintiff should sustain. Such damages would include a recompense for the labor done and materials used, and such further sum in damages as might, upon legal principles, be assessed for the breach of the contract; but the plaintiff had no right, by obstinately persisting in the work, to make the penalty upon the defendant greater than it would otherwise have been.

And the rule as established by the great weight of authority in America is summed up in the following statement in 6 R.C.L. 1029, which is quoted with approval by the Supreme Court of North Carolina in the recent case of *Novelty Advertising Co. v. Farmers' Mutual Tobacco Warehouse Co.*, 119 S.E. 196, 198 (N.C.):

While a contract is executory a party has the power to stop performance on the other side by an explicit direction to that effect, subjecting himself to such damages as will compensate the other party for being stopped in the performance on his part at that stage in the execution of the contract. The party thus forbidden cannot afterwards go on, and thereby increase the damages, and then recover such damages from the other party.

This is in accord with the earlier North Carolina decision of *Heiser v. Mears*, 27 S.E. 117 (N.C.), in which it was held that, where a buyer countermands his order for goods to be manufactured for him under an executory contract, before the work is completed, it is notice to the seller that he elects to rescind his contract and submit to the legal measure of damages, and that in such case the seller cannot complete the goods and recover the contract price. *See, also Kingman & Co. v. Western Manufacturing Co.* 92 F. 486 (8th Circuit) ; *Davis v. Bronson*, 2 N.D. 300, 50 N.W. 836; *Richards v. Manitowoc & Northern Traction Co.*, 140 Wis. 85, 121 N. W. 837/

We have carefully considered the cases of *Roehm v. Horst*, 178 U. S. 1, *Roller v. George H. Leonard & Co.* 229 F. 607 (4th Cir.), and *McCoy v. Justices of Harnett County*, 53 N.C. 272, upon which plaintiff relies; but we do not think that they are at all in point. *Roehm* merely follows the rule of *Hochster v. De la Tour*, 2 El. & Bl. 678, to the effect that where one party to any executory contract refuses to perform in advance of the time fixed for performance, the other party, without waiting for the time of performance, may sue at once for damages occasioned by the breach. The same rule is followed in *Roller*. In *McCoy*, the decision was that mandamus to require the justices of a County to pay for a jail would be denied, where it appeared that the contractor in building same departed from the plans and specifications. In the opinions in all of these some language was used which lends support to plaintiff's position, but in none of them was the point involved which is involved here.

It follows that there was error in directing a verdict for plaintiff for the full amount of its claim. The measure of plaintiff's damage, upon its appearing that notice was duly given not to build the bridge, is an amount sufficient to compensate plaintiff for labor and materials expended and expense incurred in the part performance of the contract, prior to its repudiation, plus the profit which would have been realized if it had been carried out in accordance with its terms.

Reversed.

Review Question 2. In *Rockingham County* some doubt truly existed on Luten Bridge Company's part as to whether the County's cancellation was a duly authorized act by the commissioners. (The portion of the opinion detailing the tortuous behind-the-scenes maneuvering was edited out for purposes of brevity.) Keep in mind that if the cancellation were *not* valid, Luten might be in breach if it stopped working. If you were counsel to Luten Bridge Company and it received this kind of communication from the County—which may or may not be valid—what would you advise the company to do?

PARKER v. TWENTIETH CENTURY-FOX FILM CORP.

Supreme Court of California

3 Cal. 3d 176, 474 P.2d 689, 89 Cal. Rptr. 737 (1970) (in bank)

Defendant Twentieth Century-Fox Film Corporation appeals from a summary judgment granting to plaintiff [who was legally named Shirley Parker, but was better known professionally as Shirley MacLaine] the recovery of agreed compensation under a written contract for her services as an actress in a motion picture. As will appear, we have concluded that the trial court correctly ruled in plaintiff's favor and that the judgment should be affirmed.

Plaintiff is well known as an actress, and in the contract between plaintiff and defendant is sometimes referred to as the "Artist." Under the contract, dated August 6, 1965, plaintiff was to play the female lead in defendant's contemplated production of a motion picture entitled "Bloomer Girl." The contract provided that defendant would pay plaintiff a minimum "guaranteed compensation" of \$53,571.42 per week for 14 weeks commencing May 23, 1966, for a total of \$750,000. Prior to May 1966 defendant decided not to produce the picture and by a letter dated April 4, 1966, it notified plaintiff of that decision and that it would not "comply with our obligations to you under" the written contract.

By the same letter and with the professed purpose "to avoid any damage to you," defendant instead offered to employ plaintiff as the leading actress in another film tentatively entitled "Big Country, Big Man." The compensation offered was identical, as were 31 of the 34 numbered provisions or articles of the original contract.³ Unlike "Bloomer Girl," however, which was to have been a musical production, "Big Country" was a dramatic "western type" movie. "Bloomer Girl" was to have been filmed in California; "Big Country" was to be produced in Australia. Also, certain terms in the proffered contract varied from those of the original.⁴ Plaintiff was given one week within which to accept; she did not and the offer lapsed.

³ [By the court.] Among the identical provisions was the following found in the last paragraph of Article 2 of the original contract: "We [defendant] shall not be obligated to utilize your [plaintiff's] services in or in connection with the Photoplay hereunder, our sole obligation, subject to the terms and conditions of this Agreement, being to pay you the guaranteed compensation herein provided for."

⁴ [By the court.] Article 29 of the original contract specified that plaintiff approved the director already chosen for "Bloomer Girl" and that in case he failed to act as director plaintiff was to have approval rights of any substitute director. Article 31 provided that plaintiff was to have the right of approval of the "Bloomer Girl" dance director, and Article 32 gave her the right of approval of the screenplay.

Plaintiff then commenced this action seeking recovery of the agreed guaranteed compensation.

Defendant's sole defense to this action which resulted from its deliberate breach of contract is that in rejecting defendant's substitute offer of employment plaintiff unreasonably refused to mitigate damages.

The general rule is that the measure of recovery by a wrongfully discharged employee is the amount of salary agreed upon for the period of service, less the amount which the employer affirmatively proves the employee has earned or with reasonable effort might have earned from other employment. However, before projected earnings from other employment opportunities not sought or accepted by the discharged employee can be applied in mitigation, the employer must show that the other employment was comparable, or substantially similar, to that of which the employee has been deprived; the employee's rejection of or failure to seek other available employment of a different or inferior kind may not be resorted to in order to mitigate damages.

In the present case defendant has raised no issue of reasonableness of efforts by plaintiffs to obtain other employment; the sole issue is whether plaintiff's refusal of defendant's substitute offer of "Big Country" may be used in mitigation. Nor, if the "Big Country" offer was of employment different or inferior when compared with the original "Bloomer Girl" employment, is there an issue as to whether or not plaintiff acted reasonably in refusing the substitute offer. Despite defendant's arguments to the contrary, no case cited or which our research has discovered holds or suggests that reasonableness is an element of a wrongfully discharged employee's option to reject, or fail to seek, different or inferior employment lest the possible earnings therefrom be charged against him in mitigation of damages.

In *Harris v. Nat. Union etc. Cooks, Stewards*, 116 Cal. App. 2d 759, 761, the issues were stated to be, *inter alia*, whether comparable employment was open to each plaintiff employee, and if so whether each plaintiff made a reasonable effort to secure such employment. It was held that the trial court properly sustained an objection to an offer to prove a custom of accepting a job in a lower rank when work in the higher rank was not available, as "The duty of mitigation of damages . . . does not require the plaintiff 'to seek or to accept other employment of a different or inferior kind.'"

Applying the foregoing rules to the record in the present case, with all intendments in favor of the party opposing the summary judgment motion—here, defendant—it is clear that the trial court correctly ruled that plaintiff's failure to accept defendant's tendered substitute employment could not be applied in mitigation of damages because the offer of the "Big Country" lead was of employment both different and inferior, and that no factual dispute was presented on that issue. The mere circumstance that "Bloomer Girl" was to be a musical review calling upon

plaintiff's talents as a dancer as well as an actress, and was to be produced in the City of Los Angeles, whereas "Big Country" was a straight dramatic role in a "Western Type" story taking place in an opal mine in Australia, demonstrates the difference in kind between the two employments; the female lead as a dramatic actress in a western style motion picture can by no stretch of imagination be considered the equivalent of or substantially similar to the lead in a song-and-dance production.

Additionally, the substitute "Big Country" offer proposed to eliminate or impair the director and screenplay approvals accorded to plaintiff under the original "Bloomer Girl" contract, and thus constituted an offer of inferior employment. No expertise or judicial notice is required in order to hold that the deprivation or infringement of an employee's rights held under an original employment contract converts the available "other employment" relied upon by the employer to mitigate damages, into inferior employment which the employee need not seek or accept.

Statements found in affidavits submitted by defendant in opposition to plaintiff's summary judgment motion, to the effect that the "Big County" offer was not of employment different from or inferior to that under the "Bloomer Girl" contract, merely repeat the allegations of defendant's answer to the complaint in this action, constitute only conclusionary assertions with respect to undisputed facts, and do not give rise to a triable factual issue so as to defeat the motion for summary judgment.

In view of the determination that defendant failed to present any facts showing the existence of a factual issue with respect to its sole defense—plaintiff's rejection of its substitute employment offer in mitigation of damages—we need not consider plaintiff's further contention that for various reasons, including the provisions of the original contract set forth in footnote 1, ante, plaintiff was excused from attempting to mitigate damages.

The judgment is affirmed.

SULLIVAN, Acting C.J., dissenting.

It has never been the law that the mere existence of differences between two jobs in the same field is sufficient, as a matter of law, to excuse an employee wrongfully discharged from one from accepting the other in order to mitigate damages. Such an approach would effectively eliminate any obligation of an employee to attempt to minimize damage arising from a wrongful discharge. The only alternative job offer an employee would be required to accept would be an offer of his former job by his former employer.

It is not intuitively obvious, to me at least, that the leading female role in a dramatic motion picture is a radically different endeavor from the leading female role in a musical comedy film. Nor is it plain to me that the rather qualified rights of

director and screenplay approval contained in the first contract are highly significant matters either in the entertainment industry in general or to this plaintiff in particular. Certainly, none of the declarations introduced by plaintiff in support of her motion shed any light on these issues. Nor do they attempt to explain why she declined the offer of starring in “Big Country, Big Man.” Nevertheless, the trial court granted the motion, declaring that these approval rights were “critical” and that their elimination altered “the essential nature of the employment.”

I believe that the judgment should be reversed so that the issue of whether or not the offer of the lead role in “Big Country, Big Man” was of employment comparable to that of the lead role in “Bloomer Girl” may be determined at trial.

Review Question 3. The language in *Parker v. Twentieth Century-Fox Film Corp.* is fairly sweeping. Most people’s experience suggests, however, that employers change the duties of their employees routinely. Does the court *really* mean the employee must take the new assignment only if the terms, including the location and all aspects of the contract, are identical? If not, where should the line be drawn?

C. The Certainty Limitation

KAY & ANDERSON, S.C. v. AMERITECH PUBLISHING, INC.

Court of Appeals of Wisconsin
2005 Wisc. App. LEXIS 216

PER CURIAM.

Kay & Andersen is a Madison law firm. Its office manager, Ida Carlin, signed a contract with Ameritech to list the firm and its attorneys in Ameritech’s 2001 white pages business listings and its yellow pages, in its Madison area phonebooks.

Ameritech’s 2001 phone books did not include the white page listing for the firm or for Randal J. Andersen, one of two partners in the firm. The book also failed to list its one associate in the proper alphabetical place. The firm received fewer than expected new clients and less than expected new client revenue in 2001 and 2002. Its complaint in this proceeding alleged that Ameritech’s listing errors were responsible for the clientele and revenue loss. This appeal results from the trial court’s decision awarding \$183,000 to the firm to compensate for that lost revenue.

[The court concludes there was sufficient evidence to find that Ameritech breached the contract.]

The firm's evidence on damages included the following. Between 1997 and 2000 it obtained between 99 and 129 new clients annually and received new client revenues between \$114,000 and \$298,000. During the same period, overall revenues varied between \$639,000 and \$780,000. In 2001, the firm received 80 new clients and \$91,000 in new client revenue and earned \$705,000 in overall revenue. In 2002, it received 87 new clients and \$122,000 in new client revenue and \$658,000 in fee revenue. Based on this financial data, the firm's two partners testified the firm could expect average yearly revenues of \$731,000 with \$183,000 representing new client revenue. Consequently, they calculated that the firm's \$213,000 in new client revenue in 2001 and 2002 fell \$152,000 below what they expected. It was also the partners' testimony that the sole reason for this shortfall was the 2001 white page listing errors that prevented potential new clients from contacting them.

Ameritech presented an expert accounting witness who offered a different method of computing the firm's lost revenue and testified that using his method the losses attributable to the listing errors were far less. However, the trial court concluded his method was unreliable and produced an unreasonably small damage amount. While noting that precise calculations were impossible, the court held Ameritech had not demonstrated a more reasonable or accurate measure of losses than the firm. The court also found the firm's loss of expected clients and revenue was solely due to the listing errors and noted it would be pure speculation to find other reasons for the less than expected number of clients. The court concluded "Ameritech failed to prove any other factors that would explain the loss of revenues attributed to new customers as described in the testimony of the plaintiffs. Therefore, plaintiffs' damage numbers are accepted." The resulting damages included the \$152,000 the firm calculated for its 2001-02 losses and an additional sum for carryover losses in future years.

There was sufficient evidence to support the trial court's damage award. Ameritech characterizes the firm's computation of its damages as illogical and speculative. However, a business's past performance is admissible to prove the expected return in a given year. See *Cutler Cranberry Co. v. Oakdale Electric Coop.*, 254 N.W.2d 234 (Wis. 1977). Consequently, Ameritech's arguments that question the firm's interpretation of its past performance address only the weight and credibility of the testimony. Those are matters which the trial court, and not this court, determines. See Wis. Stat. § 805.17(2). In determining the firm provided the more credible calculation of damages, the trial court reasonably applied the following principle.

In *Essock v. Mawhinney*, 3 Wis. 2d 258, 270, 88 N.W.2d 659 (Wis. 1985), the court favorably quoted the following from 15 AM. JUR. 2D *Damages* § 23, at 414:

It is now generally held that the uncertainty which prevents a recovery is uncertainty as to the fact of the damage and not to its amount and

that where it is certain that damage has resulted, mere uncertainty as to the amount will not preclude the right of recovery. This view has been sustained where, from the nature of the case, the extent of injury and the amount of damage are not capable of exact and accurate proof. Under such circumstances all that can be required is that the evidence with such certainty as the nature of the particular case may permit lay a foundation which will enable the trier of fact to make a fair and reasonable estimate.

Cutler Cranberry, 78 Wis. 2d at 233-34.

By the Court.—Judgment affirmed.

HOLLYWOOD FANTASY CORP. v. GABOR

United States Court of Appeals for the Fifth Circuit
151 F.3d 203 (5th Cir. 1998)

ROSENTHAL, District Judge:

Appellee Hollywood Fantasy Corporation was briefly in the business of providing “fantasy vacation” packages that would allow participants to “make a movie” with a Hollywood personality and imagine themselves movie stars, for one week, for a fee. In May 1991, Hollywood Fantasy planned to offer its second fantasy vacation package, in San Antonio, Texas. Hollywood Fantasy arranged to have Zsa Zsa Gabor as one of two celebrities at the event. Two weeks before the fantasy vacation event, Ms. Gabor cancelled her appearance. A short time later, Hollywood Fantasy cancelled the vacation event, to which it had sold only two tickets. A short time after that, Hollywood Fantasy went out of business.

Leonard Saffir created Hollywood Fantasy and served as its chief executive officer. The company Mr. Saffir created charged each vacation “client” \$7,500 for a week of “pampering,” instruction on making movies, rehearsals, and a “starring” role in a short videotaped film with a “nationally known” television or movie star. Mr. Saffir hoped that “bloopers” and “outtakes” from the videotapes would ultimately become the basis for a television series. A new venture, Hollywood Fantasy had conducted only one vacation event before the package scheduled to take place in San Antonio in May 1991. The first event, held in Palm Springs, California, had received some media coverage, but had lost money.

This case began with a letter Hollywood Fantasy sent Zsa Zsa Gabor dated March 4, 1991. The letter opened with the following language:

This will confirm our agreement whereby Hollywood Fantasy Corporation (HFC) will employ you under the following terms and conditions: . . .

The letter set out the terms and conditions of Ms. Gabor's appearance in fourteen numbered paragraphs. The terms and conditions specified the dates of employment; the hours of work; the duties required; the payment; and certain perquisites to be provided. The letter stated that Ms. Gabor was to be employed from May 2-4, 1991, in San Antonio, Texas; was to be "on call" from after breakfast until before dinner each day; was to act in videotaped "movie" scenes with the clients, using scripts and direction provided by Hollywood Fantasy, and was to join the clients for lunch and dinner; was to allow Hollywood Fantasy to use her name and photograph for publicity; and was to provide media interviews "as appropriate" during her stay in San Antonio. Hollywood Fantasy was to pay Ms. Gabor a \$10,000 appearance fee and \$1,000 for miscellaneous expenses. Hollywood Fantasy would also provide Ms. Gabor two first-class round-trip plane fares from Los Angeles; transportation to the Los Angeles airport and in San Antonio; hair and makeup services; meals; hotel expenses, excluding long distance telephone calls; and a hotel suite with "two bath rooms if available."

Ms. Gabor made three handwritten changes to this letter before signing and returning it to Mr. Saffir. She inserted the word "one" into the sentence stating that she would make herself available for media interviews; inserted the words "two bedroom" above the sentence describing the hotel suite that was to be provided in San Antonio; and added the words "wardrobe to be supplied by Neiman Marcus" to the paragraph outlining the perquisites.

The last paragraph of the terms and conditions provided an "out clause":

[Hollywood Fantasy] agrees that if a significant acting opportunity in a film comes up [Gabor] will have the right to cancel [her] appearance in San Antonio by advising [Hollywood Fantasy] in writing by April 15, 1991.

The final paragraph of the letter stated: "Please sign a copy of this agreement and fax it to me . . . as soon as possible so we can proceed." Ms. Gabor signed the letter in a signature blank above the words "Agreed and accepted," and sent it back to Leonard Saffir, who had already signed as the chief executive officer for Hollywood Fantasy.

On April 10, Ms. Gabor and Mr. Saffir talked by telephone. The parties differ as to the substance of that conversation. Mr. Saffir asserts that they discussed the changes Ms. Gabor had made and "everything was agreed." Ms. Gabor asserts that Mr. Saffir acted as if the original offer had been accepted. The parties agree that Ms. Gabor sent Mr. Saffir a telegram dated April 15, 1991, stating:

In accordance with the contract that exists between us the purpose of this telegram is to inform you that I must terminate it because I am due to be involved in preproduction and a promotion film for a motion picture I am contracted to do. The name of the film is Queen of Justice produced by

Metro Films of Los Angeles. . . . I am very sorry to cause you any discomfort but will be happy to try to help in supplying you with a replacement and hopefully we'll be able to do something together in the very near future.

Hollywood Fantasy unsuccessfully attempted to replace Ms. Gabor for the San Antonio event. The San Antonio event was cancelled; the two ticket purchasers received their money back; Hollywood Fantasy went out of business; and this litigation began.

Ms. Gabor did not appear at the docket call scheduled for November 9, 1992. Following a default judgment on liability and a jury trial on damages, the jury awarded Hollywood Fantasy \$3,000,000. The district court entered final judgment in that amount. Ms. Gabor moved to set aside the judgment on the ground that she did not receive notice of the docket call. The district court granted Ms. Gabor's motion to vacate the judgment and ordered a new trial. After a second trial, the jury awarded Hollywood Fantasy \$100,000 on its breach of contract claim. In the [post-trial] order, the district court found that a contract did exist between Ms. Gabor and Hollywood Fantasy, rejecting Ms. Gabor's argument that her handwritten changes to the March 4, 1991 letter materially modified and rejected Hollywood Fantasy's offer. The district court also upheld the jury's finding that Ms. Gabor's cancellation was not based on "a significant acting opportunity in a film," as the contract permitted. The district court entered judgment in favor of Hollywood Fantasy for \$100,000, plus attorneys' fees and post-judgment interest. Ms. Gabor timely appealed.

[The court affirms the district court on the contract formation and breach issues.]

At trial, Ms. Gabor moved for judgment as a matter of law that there was insufficient evidence to support the jury's award of \$100,000 for breach of contract. The district court denied Ms. Gabor's motion. Ms. Gabor renews her objection here.

"In a federal case involving a state law claim, state law determines the kind of evidence that may be produced to support a verdict, but federal law establishes the quantum of evidence needed to support a verdict." *Parham v. Carrier Corp.*, 9 F.3d 383, 386 (5th Cir. 1993) (citations omitted). ; *see also Jones v. Wal-Mart Stores, Inc.*, 870 F.2d 982, 986 (5th Cir. 1989). This court will uphold the district court's denial of a challenge to the sufficiency of the evidence if there is substantial evidence to support the jury's verdict. *Bradley*, 130 F.3d at 174.

"It is a general rule that the victim of a breach of contract should be restored to the position he would have been in had the contract been performed." *Mistletoe Express Serv. of Okla. City, Okla. v. Locke*, 762 S.W.2d 637, 638 (Tex. App.—Texarkana 1988, no writ). "However, an injured party may, if he so chooses, ignore the element of profits and recover as damages his expenditures in reliance." *Nelson*

v. Data Terminal Sys., Inc., 762 S.W.2d 744, 748 (Tex. App.—San Antonio 1988, writ denied) (citing Restatement (Second) of Contracts §§ 347, 349).

The \$100,000 damages award cannot be supported as the recovery of lost profits. Mr. Saffir testified that Hollywood Fantasy lost \$250,000 in profits from future fantasy vacation events and at least \$1,000,000 in future profits from the creation of a television series based on “bloopers” and “outtakes” from the videotapes of clients “acting” with Hollywood personalities. Although “recovery of lost profits does not require that the loss be susceptible to exact calculation,” *Szczepanik v. First Southern Trust Co.*, 883 S.W.2d 648, 649 (Tex. 1994), lost profits must be proved with “reasonable certainty.” *Texas Instruments, Inc. v. Teletron Energy Management, Inc.*, 877 S.W.2d 276, 279 (Tex. 1994). “[A] party claiming injury from lost profits need not produce in court the documents that support his opinions or estimates.” *Ishin Speed Sport, Inc. v. Rutherford*, 933 S.W.2d 343, 351 (Tex. App.—Fort Worth 1996, no writ). A witness may testify “from personal knowledge as to what profits would have been.” *Naegeli Transp. v. Gulf Electroquip, Inc.*, 853 S.W.2d 737, 740 (Tex. App.—Houston [14th Dist.] 1993, writ denied). However, “at a minimum, opinions or estimates of lost profits must be based on objective facts, figures or data from which the amount of lost profits may be ascertained.” *Szczepanik*, 883 S.W.2d at 649. “Mere speculation” of the amount of lost profits is insufficient. *Thedford v. Missouri Pac. R.R. Co.*, 929 S.W.2d 39, 47 (Tex. App.—Corpus Christi 1996, writ denied).

Leonard Saffir’s testimony that Hollywood Fantasy lost \$250,000 in future profits was based on his estimate that Hollywood Fantasy would make a \$25,000 profit from each of ten future events. Hollywood Fantasy was a new venture. It had put on one event, in which nine people participated, and in which it had lost money. Two weeks before the San Antonio event, only two people had bought tickets for the event. Hollywood Fantasy had no commitments to, or arrangements for, specific future events. “Profits which are largely speculative, as from an activity dependent on uncertain or changing market conditions, or on chancy business opportunities, . . . or on the success of a new and unproven enterprise, cannot be recovered.” *Texas Instruments*, 877 S.W.2d at 279. “The mere hope for success of an untried enterprise, even when that hope is realistic, is not enough for recovery of lost profits.” *Id.* at 280. In *Texas Instruments*, the Texas Supreme Court made it clear that the relevant “enterprise” in the lost profits inquiry is “not the business entity, but the activity which is alleged to have been damaged.” *Id.* There was no evidence at trial that the “movie fantasy vacation” enterprise promoted by Hollywood Fantasy had been a successful enterprise in any context. There was no evidence that the Hollywood Fantasy management had ever been involved in any prior fantasy vacation enterprise, let alone a successful one..

In *Texas Instruments*, the Texas Supreme Court stated that even a new enterprise may attempt to recover lost profits when there are “firmer reasons” to “expect [the] business to yield a profit.” *Texas Instruments*, 877 S.W.2d at 280. There

was no evidence at trial that Hollywood Fantasy had “firm” reasons to expect a profit. Nine participants attended the Palm Springs event; not all of those participants paid the full \$7,500 price of admission and only “some” of the Hollywood Fantasy employees were paid for their work. As of April 15, 1991, two weeks before the San Antonio event, only two tickets had been sold. Mr. Saffir’s testimony that he still expected twenty participants was based on the optimistic but unsupported assertion that people generally “don’t send in their money right away.”

Hollywood Fantasy’s claim for loss of television revenue is even more speculative. Mr. Saffir admitted that he had not sold a television pilot, let alone a series, based on the fantasy vacation videotapes. Mr. Saffir testified that the actors appearing in the videotapes could have unilaterally declined to permit Hollywood Fantasy to use the tapes in a television pilot. Mr. Saffir testified that unidentified producers and others were enthusiastic about the “concept” of such a television series, but he had difficulty even estimating what the profits from a series might be. No “objective facts, figures, or data” substantiated the estimate of lost profits.

Hollywood Fantasy’s claims for lost profits also fail because there was no evidence of how Hollywood Fantasy estimated the profits or what data it used to do so. *See National Union Fire*, 955 S.W.2d at 132 (noting that lost profits may be recovered “if factual data is available to furnish a sound basis for computing probable losses”); *Theford*, 929 S.W.2d at 49 (“Testimony about lost profits must at least be based upon some factual data.”).

Although Hollywood Fantasy did not present evidence to base an award of compensatory damages on either lost profits or lost investment, it did present sufficient evidence as to certain out-of-pocket expenses to justify their recovery. Mr. Saffir testified that Hollywood Fantasy incurred the following out-of-pocket expenses for the San Antonio event: (1) \$8,500 in printing costs for color brochures and press releases; (2) \$12,000 in marketing costs for mailings and advertising; (3) \$22,000 in personnel and miscellaneous expenses, including air fares, staff accommodations, script-writing costs, telephone calls, and logo t-shirts; (4) \$9,000 in travel expenses for Mr. Saffir and members of the Hollywood Fantasy “staff,” including Margo Mayor, Hollywood Fantasy’s president; and (5) \$6,000 in expenses relating to preparations to film the San Antonio event for a possible television pilot. These expenses total \$57,500.

Ms. Gabor objects that this evidence cannot form the basis of a damages award because Mr. Saffir testified that there were documents relating to a few of these expenses, but did not produce any documents at trial. However, the Texas cases Ms. Gabor cites to support her argument do not hold that documentary evidence is required for the recovery of out-of-pocket expenses.

Ms. Gabor presented no evidence controverting Mr. Saffir’s testimony as to Hollywood Fantasy’s lost out-of-pocket expenses for the San Antonio event. Mr.

Saffir's testimony as to Hollywood Fantasy's out-of-pocket expenses is sufficient to support an award of \$57,500 for breach of contract, but not to support an award of \$100,000.⁵ The award of \$100,000 is reversed in part on the basis that the evidence disclosed in the record does not support compensatory damages beyond \$57,500.

Review Question 4. The owners of Hollywood Fantasy Corporation obviously had plans to make a great deal of money off their new business. Why did they end up getting only reliance damages? Why was Ms. Gabor not liable for all their future losses? Can you articulate a rule that explains the outcome?

Review Question 5. Compare the very different language used by the courts *Hollywood Fantasy* and *Kay & Anderson*. Are they applying the same test? Or alternatively, is the Texas rule applied in *Hollywood Fantasy* much more restrictive than that used by the Wisconsin court?

Review Question 6. A footnote in *Hollywood Fantasy* states that the plaintiff had to pay \$15,000 back to two persons who had already purchased tickets. Why did the court not consider this an "out of pocket" expense?

⁵ [By the court.] Hollywood Fantasy cannot recover the \$15,000 it refunded to the two individuals who had bought tickets to the San Antonio event before it was cancelled. The ticket price refund was not an out-of-pocket expense. Hollywood Fantasy presented no testimony as to what portion, if any, of this amount it would have kept as profit had the event gone forward with Ms. Gabor's participation.

Problems

Problem 25.1

Homeowner's roof is seriously damaged in a windstorm. He files a claim with Arcturus Insurance, which carries his homeowner's policy. After repeated contact over several months, Arcturus ultimately refuses to pay the claim. Just before the final denial, Homeowner is on the roof putting a tarpaulin over a leaking point. He slips, falls from the roof, and is seriously injured. At trial, the jury finds that Homeowner's claim was valid and that Arcturus breached the contract by failing to pay. In addition to the damage to the house, however, Homeowner demands payment for his injuries, arguing that if Arcturus had not breached the contract the roof would have been fixed and he would not have been on the roof at the time he fell. Are his personal injury damages recoverable?

Problem 25.2

Mina is a second-year law student who is at the top of her class at an elite private university in the Northeast. As such, she is offered 12-week summer clerkships by many of the world's top law firms. She is especially interested in cutting edge work for entertainment industry clients, and so takes a clerkship at the very prestigious mid-sized Los Angeles firm of Wolfram & Hart. She graciously turns down all of her other offers. Two weeks before the clerkship is to start, Wolfram & Hart informs her that it will not need her for the summer. Mina remonstrates with them, pointing out her reliance on their promise. The hiring partner tells her it's just tough luck, baby. "That's Hollywood, kid." Mina sues, seeking damages for the \$60,000 she was to have made over those 12 weeks.

(a) Assume that Mina cannot get another private firm legal position for the summer. Instead, she makes \$3,600 as a research assistant for a professor. What remedies does she have?

(b) Assume that Wolfram & Hart instead offers to have her work in the mailroom at the same pay, telling her she can list on her resume that she "worked on many matters" for the firm during the summer. If she turns this down, has Mina failed to mitigate her damages?

(c) Assume instead that Sterling & Bond, one of New York's most prestigious firms, hears that Mina is available and offers her a job in its New York at the same pay she would have received at Wolfram & Hart. She does not want to practice in New York. If she turns it down, has she failed to mitigate her damages?

Problem 25.3

Ann signs a contract to acquire a franchise to build a new Burger Queen fast-food restaurant on the corner of 12th and Vine Streets. Ann is a marketing executive who has never previously run a restaurant. She chose BQ because it is a popular and well-run franchise system that usually provides solid profits for franchise owners. The projected site has been approved by the BQ real estate department as having suitable traffic for a franchise, the land is properly zoned, and Ann has an option on the property and the necessary capital to build and run the franchise. BQ, however, breaches the contract and refuses to award her a franchise. She sues, claiming lost profits for her aborted business.

At trial Ann will show that (1) only about 5 percent of BQ franchises lose money; (2) the average annual profit of a franchise is \$250,000, (3) she would be expected to own the franchise for at least 10 years, and therefore (4) she estimates that the total profits she lost on the transaction are \$2.3 million. BQ argues that this is wholly speculative since Ann has never run this kind of business before. It also introduces evidence that Ann had also explored the possibility of a Wallyburger franchise—Wallyburger is BQ’s chief competitor in the fast-food burger market—and could have been placed on the same spot. A Wallyburger representative will testify that Ann had been approved for a Wallyburger franchise, and the company would have been happy to have one of its restaurants on that site. Because a Wallyburger franchise yields annual profits nearly as high as that of BG, the company argues that Ann failed to mitigate her damages by buying a competing franchise.

How much of her \$2.3 million in expected profits should Ann get?

Unit 26: Special Remedies

REMEDIES Part Four

FOCUS OF THIS UNIT

Having covered the “big three” principal measures of damages in American contract law (expectancy, reliance, and restitution), along with the limitations on such damages (foreseeability, Avoidability, and certainty), we now turn our attention to what we here categorize as “special remedies.” The two remedies covered in this unit are, as you will see, more narrowly available than the big three, but they are an integral part of the toolkit of the practicing lawyer who must understand when they are and are not in play.

Specific Performance. One type of special remedy that you have heard of elsewhere by this point is *specific performance*. This remedy is the particular contract-law application of the broader power of courts to issue injunctions—orders compelling specific action or non-action by a party, generally issued under threat of contempt for non-compliance. You may have encountered injunctive relief (or at least references to it) in other law school classes. An order of specific performance compels a party to do what the party promised. In a contract to buy land or goods that qualify as truly “unique,” for example, a court can order the breaching seller to perform the deal. In much of the world, this judicially-managed remedy is preferred and is used frequently. For common-law jurisdictions like the United States, specific performance is disfavored and applicable only in certain qualifying situations. Be aware that some courts discussing specific performance do so with little or no use of the term “specific performance.” If, however, a court is evaluating a party’s request for an injunction and the injunction is one that would order a breaching party to perform its contractual obligations, then the underlying issue is one of specific performance.

Sections 357 through 369 of the Restatement (Second) of Contracts provides some substantial detail on when specific performance is and is not available, and this unit addresses some of those highlights. In Uniform Commercial Code cases, specific performance is sometimes available for buyers and sellers when the other side breaches. The sellers’ specific performance remedy is under section 2-709, which is entitled “Action for the Price.” This provision does not raise many of the concerns of other types of specific performance because a buyer’s breach is usually a simply

failure to pay money. As you should know by now, the common-law system has absolutely no qualms about awarding money damages. For buyers, the specific performance remedy is more narrowly tailored, and section 2-716 (“Buyer’s Right to Specific Performance or Replevin”) mimics many of the restrictions included in the Restatement, such as by reference to “unique” goods. Finally, considering that countries with a civil law system do not disfavor specific performance nearly as much as common-law jurisdictions, it should come as no surprise that the CISG provides for the remedy of specific performance. Article 62 gives the seller an action for the price very much like UCC section 2-709. Article 46(1) provides that a buyer generally may require the seller to perform his obligations unless the buyer has resorted to an “inconsistent” remedy.

Liquidated Damages. Can parties contractually agree in advance what their damages will be in the event of breach? The answer to that question is a definite and unequivocal . . . sometimes. Damages agreed to in advance are known as *liquidated damages*, and they are the second special remedy that we will cover in this unit. The term “liquidated” does not mean that the party is awarded water. As used in this context, liquidated refers to a claim being reduced to a specific amount, as opposed to a claim that is “unliquidated” and not yet known.⁶ If a contract term provides for liquidated damages that function as a “penalty” imposed on the breaching party, American courts will refuse to enforce the clause.

Section 356 of the Restatement (Second) of Contracts describes the well-established rules on when liquidated damages provisions are enforceable. The amount chosen by the parties must be a reasonable estimate of anticipated or difficult-to-prove losses. For sale-of-goods contracts, Uniform Commercial Code section 2-718 generally tracks the common-law restrictions on liquidated damages, though it also contains a “statutory liquidated damages” rule that is available as a remedy under some specified circumstances. The UCC allows a party to retain some or all of a prepaid deposit following the other side’s breach, even where the contract does not provide for liquidated damages. The CISG, for its part, does not address the question of liquidated damages, either by sanctioning them or restricting them. Such silence raises the possibility that a court will apply its own local law on the matter, even where otherwise applying the CISG.

⁶ [You have probably heard the word “liquid” used in the same sense in other contexts, such as “liquid assets” (cash and things can be quickly and easily turned into cash) or “liquidity crises” for banks (that is, having plenty of assets but not enough cash to pay bills. Thus, “liquidating” in this sense means turning an unquantified legal right into a specific sum of cash.—Eds.]

Cases and Materials

A. Specific Performance

VAN WAGNER ADVERTISING CORP. v. S&M ENTERPRISES

Court of Appeals of New York
67 N.Y.2d 186, 492 N.E.2d 756 (1986)

KAYE, J.

[Barbara Michaels owned a building in New York City whose eastern wall faced the Midtown Tunnel exit at East 36th Street in Manhattan, and may perhaps have been the single most visible site for a billboard in the city. In 1981 she leased space to Van Wagner Advertising to put up a lighted billboard, which it did. In 1982, Michaels sold the building to S&M Enterprises, and the new owner, citing an ambiguous provision in the lease, terminated it and ordered Van Wagner to remove the billboard. Van Wagner sued, and at trial successfully showed that the termination was improper and that S&M had breached the contract. At issue was the remedy; Van Wagner sought specific performance and thus the right to put up and lease the billboard. The trial court refused specific performance and instead awarded monetary damages. The Appellate Division affirmed.]

Given defendant's unexcused failure to perform its contract, we next turn to a consideration of remedy for the breach: Van Wagner seeks specific performance of the contract, S&M urges that money damages are adequate but that the amount of the award was improper.⁷

Whether or not to award specific performance is a decision that rests in the sound discretion of the trial court, and here that discretion was not abused.

⁷ [By the court] We note that the parties' contentions regarding the remedy of specific performance in general, mirror a scholarly debate that has persisted throughout our judicial history, reflecting fundamentally divergent views about the quality of a bargained-for promise. While the usual remedy in Anglo-American law has been damages, rather than compensation "in kind," see Oliver W. Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897); OLIVER W. HOLMES, JR., THE COMMON LAW 299-301 (1881); GRANT GILMORE, THE DEATH OF CONTRACT 14-15 (1974), the current trend among commentators appears to favor the remedy of specific performance, see E. Allen Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145, 1156 (1970); Peter Linzer, *On the Amorality of Contract Remedies—Efficiency, Equity, and the Second Restatement*, 81 COLUM. L. REV. 111 (1981); and Alan Schwartz, *The Case for Specific Performance*, 89 YALE L.J. 271 (1979), but the view is not unanimous, see RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 4.9, at 89-90 (2d ed. 1977); Edward Yorio, *In Defense of Money Damages for Breach of Contract*, 82 COLUM. L. REV. 1365 (1982).

Considering first the nature of the transaction, specific performance has been imposed as the remedy for breach of contracts for the sale of real property, but the contract here is to lease rather than sell an interest in real property. While specific performance is available, in appropriate circumstances, for breach of a commercial or residential lease, specific performance of real property leases is not in this State awarded as a matter of course. *See Gardens Nursery School v Columbia Univ.*, 94 Misc. 2d 376, 378).⁸

Van Wagner argues that specific performance must be granted in light of the trial court's finding that the "demised space is unique as to location for the particular advertising purpose intended." The word "uniqueness" is not, however, a magic door to specific performance. A distinction must be drawn between physical difference and economic interchangeability. The trial court found that the leased property is physically unique, but so is every parcel of real property and so are many consumer goods. Putting aside contracts for the sale of real property, where specific performance has traditionally been the remedy for breach, uniqueness in the sense of physical difference does not itself dictate the propriety of equitable relief.

By the same token, at some level all property may be interchangeable with money. Economic theory is concerned with the degree to which consumers are willing to substitute the use of one good for another, the underlying assumption being that "every good has substitutes, even if only very poor ones," and that "all goods are ultimately commensurable." Anthony T. Kronman, *Specific Performance*, 45 U. CHI. L. REV. 351, 359 (1978). Such a view, however, could strip all meaning from uniqueness, for if all goods are ultimately exchangeable for a price, then all goods may be valued. Even a rare manuscript has an economic substitute in that there is a price for which any purchaser would likely agree to give up a right to buy it, but a court would in all probability order specific performance of such a contract on the ground that the subject matter of the contract is unique.

The point at which breach of a contract will be redressable by specific performance thus must lie not in any inherent physical uniqueness of the property but instead in the uncertainty of valuing it:

What matters, in measuring money damages, is the volume, refinement, and reliability of the available information about substitutes for the subject matter of the breached contract. When the relevant information is thin and unreliable, there is a substantial risk that an award of money damages will either exceed or fall short of the promisee's actual loss. Of

⁸ [By the court] *But see* 5ARTHUR L. CORBIN, CONTRACTS § 1143, at 131; at 7, n 62 (1971 Pocket Part); 11 SAMUEL WILLISTON, CONTRACTS § 1418A (3d ed. 1979); JOHN NORTON POMEROY & JOHN C. MANN, SPECIFIC PERFORMANCE OF CONTRACTS § 9 at 18-19 (3d ed. 1926); RESTATEMENT (SECOND) OF CONTRACTS § 360 cmt. a, illus.2; *id.* § 360 cmt. e; *cf.* *City Stores Co. v Ammerman*, 266 F. Supp. 766 (D.D.C. 1967), *aff'd per curiam* 394 F.2d 950 (D.C. Cir. 1968).

course this risk can always be reduced—but only at great cost when reliable information is difficult to obtain. Conversely, when there is a great deal of consumer behavior generating abundant and highly dependable information about substitutes, the risk of error in measuring the promisee’s loss may be reduced at much smaller cost. In asserting that the subject matter of a particular contract is unique and has no established market value, a court is really saying that it cannot obtain, at reasonable cost, enough information about substitutes to permit it to calculate an award of money damages without imposing an unacceptably high risk of undercompensation on the injured promisee. Conceived in this way, the uniqueness test seems economically sound.

Kronman, 45 U. CHI. L. REV., at 362. This principle is reflected in the case law and is essentially the position of the Restatement, which lists “the difficulty of proving damages with reasonable certainty” as the first factor affecting adequacy of damages. Restatement (Second) of Contracts § 360(a) (1981). Thus, the fact that the subject of the contract may be “unique as to location for the particular advertising purpose intended” by the parties does not entitle a plaintiff to the remedy of specific performance.

Here, the trial court correctly concluded that the value of the “unique qualities” of the demised space could be fixed with reasonable certainty and without imposing an unacceptably high risk of undercompensating the injured tenant. Both parties complain: Van Wagner asserts that while lost revenues on the Asch contract may be adequate compensation, that contract expired February 28, 1985, its lease with S&M continues until 1992, and the value of the demised space cannot reasonably be fixed for the balance of the term. S&M urges that future rents and continuing damages are necessarily conjectural, both during and after the Asch contract, and that Van Wagner’s damages must be limited to 60 days—the period during which Van Wagner could cancel Asch’s contract without consequence in the event Van Wagner lost the demised space. S&M points out that Van Wagner’s lease could remain in effect for the full 10-year term, or it could legitimately be extinguished immediately, either in conjunction with a bona fide sale of the property by S&M, or by a re-letting of the building if the new tenant required use of the billboard space for its own purposes. Both parties’ contentions were properly rejected.

First, it is hardly novel in the law for damages to be projected into the future. Particularly where the value of commercial billboard space can be readily determined by comparisons with similar uses—Van Wagner itself has more than 400 leases—the value of this property between 1985 and 1992 cannot be regarded as speculative. Second, S&M having successfully resisted specific performance on the ground that there is an adequate remedy at law, cannot at the same time be heard to contend that damages beyond 60 days must be denied because they are conjectural. If damages for

breach of this lease are indeed conjectural, and cannot be calculated with reasonable certainty, then S&M should be compelled to perform its contractual obligation by restoring Van Wagner to the premises. Moreover, the contingencies to which S&M points do not, as a practical matter, render the calculation of damages speculative. While S&M could terminate the Van Wagner lease in the event of a sale of the building, this building has been sold only once in 40 years; S&M paid several million dollars, and purchased the building in connection with its plan for major development of the block. The theoretical termination right of a future tenant of the existing building also must be viewed in light of these circumstances. If any uncertainty is generated by the two contingencies, then the benefit of that doubt must go to Van Wagner and not the contract violator. Neither contingency allegedly affecting Van Wagner's continued contractual right to the space for the balance of the lease term is within its own control; on the contrary, both are in the interest of S&M. Thus, neither the need to project into the future nor the contingencies allegedly affecting the length of Van Wagner's term render inadequate the remedy of damages for S&M's breach of its lease with Van Wagner.

Review Question 1. Parties seeking specific performance will generally assert that monetary damages are inadequate compensation because of the “uniqueness” of the breaching party's promised performance. The *Van Wagner* court cautions that “[t]he word ‘uniqueness’ is not, however, a magic door to specific performance. A distinction must be drawn between physical difference and economic interchangeability.” Could you explain what that statement means if you were called upon to do so? The principle involved is actually a rather important one for practicing lawyers to understand.

LACLEDE GAS CO. v. AMOCO OIL CO.
United States Court of Appeals, Eighth Circuit
522 F.2d 33 (8th Cir. 1975)

ROSS, Circuit Judge.

[In September 1970, Amoco contracted to supply Laclede with its requirements of propane for Laclede to sell to its residential customers.]

For a time the parties operated satisfactorily under this agreement, and some 17 residential subdivisions were brought within it by supplemental letters. However, for various reasons, including conversion to natural gas, the number of developments under the agreement had shrunk to eight by the time of trial. These were all mobile home parks.

During the winter of 1972-73 Amoco experienced a shortage of propane and voluntarily placed all of its customers, including Laclede, on an 80% Allocation basis, meaning that Laclede would receive only up to 80% of its previous requirements. Laclede objected to this and pushed Amoco to give it 100% of what the developments needed. Some conflict arose over this before the temporary shortage was alleviated.

Then, on April 3, 1973, Amoco notified Laclede that its Wood River Area Posted Price of propane had been increased by three cents per gallon. Laclede objected to this increase also and demanded a full explanation. None was forthcoming. Instead Amoco merely sent a letter dated May 14, 1973, informing Laclede that it was “terminating” the September 21, 1970, agreement effective May 31, 1973. It claimed it had the right to do this because “the Agreement lacks ‘mutuality.’”

The district court felt that the entire controversy turned on whether or not Laclede’s right to “arbitrarily cancel the Agreement” without Amoco having a similar right rendered the contract void “for lack of mutuality” and it resolved this question in the affirmative. We disagree with this conclusion and hold that settled principles of contract law require a reversal.

[The Court of Appeals determined that Amoco could not void the contract based on an alleged lack of mutuality and that Amoco’s refusal to deliver propane was therefore a breach of contract. The court then turned its attention to Laclede’s claim that it was eligible for specific performance in the form of an injunction requiring Amoco to continue delivering propane under the contract.]

Generally the determination of whether or not to order specific performance of a contract lies within the sound discretion of the trial court. However, this discretion is, in fact, quite limited; and it is said that when certain equitable rules have been met and the contract is fair and plain “specific performance goes as a matter of right.” *Miller v. Coffeen*, 365 Mo. 204, 280 S.W.2d 100, 102 (1955), quoting, *Berberet v. Myers*, 240 Mo. 58, 77, 144 S.W. 824, 830 (1912). (Emphasis omitted.)

With this in mind we have carefully reviewed the very complete record on appeal and conclude that the trial court should grant the injunctive relief prayed. We are satisfied that this case falls within that category in which specific performance should be ordered as a matter of right. See *Miller v. Coffeen*, supra, 280 S.W.2d at 102.

Amoco contends that four of the requirements for specific performance have not been met. Its claims are: (1) there is no mutuality of remedy in the contract; (2) the remedy of specific performance would be difficult for the court to administer without constant and long-continued supervision; (3) the contract is indefinite and uncertain; and (4) the remedy at law available to Laclede is adequate. The first three contentions have little or no merit and do not detain us for long.

There is simply no requirement in the law that both parties be mutually entitled to the remedy of specific performance in order that one of them be given that remedy by the court.

While a court may refuse to grant specific performance where such a decree would require constant and long-continued court supervision, this is merely a discretionary rule of decision which is frequently ignored when the public interest is involved.

Here the public interest in providing propane to the retail customers is manifest, while any supervision required will be far from onerous.

Section 370 of the [First] Restatement of Contracts (1932)⁹ provides:

Specific enforcement will not be decreed unless the terms of the contract are so expressed that the court can determine with reasonable certainty what is the duty of each party and the conditions under which performance is due.

We believe these criteria have been satisfied here. [As] to all developments for which a supplemental agreement has been signed, Amoco is to supply all the propane which is reasonably foreseeably required, while Laclede is to purchase the required propane from Amoco and pay the contract price therefor. The parties have disagreed over what is meant by “Wood River Area Posted Price” in the agreement, but the district court can and should determine with reasonable certainty what the parties intended by this term and should mold its decree, if necessary accordingly. Likewise, the fact that the agreement does not have a definite time of duration is not fatal since the evidence established that the last subdivision should be converted to natural gas in 10 to 15 years. This sets a reasonable time limit on performance and the district court can and should mold the final decree to reflect this testimony.

It is axiomatic that specific performance will not be ordered when the party claiming breach of contract has an adequate remedy at law. This is especially true when the contract involves personal property as distinguished from real estate.

However, in Missouri, as elsewhere, specific performance may be ordered even though personalty is involved in the “proper circumstances.” Mo. Rev. Stat. [UCC § 2-716(1)]; Restatement of Contracts, *supra*, § 361. And a remedy at law adequate to defeat the grant of specific performance “must be as certain, prompt, complete, and efficient to attain the ends of justice as a decree of specific performance.” *National Marking Mach. Co. v. Triumph Mfg. Co.*, 13 F.2d 6, 9 (8th Cir. 1926).

One of the leading Missouri cases allowing specific performance of a contract relating to personalty because the remedy at law was inadequate is *Boeving v. Vandover*, 240 Mo. App. 117, 218 S.W.2d 175, 178 (1949). In that case the plaintiff

⁹ [The substantially similar provision in the Restatement (Second) of Contracts is located in section 362.—Eds.]

sought specific performance of a contract in which the defendant had promised to sell him an automobile. At that time (near the end of and shortly after World War II) new cars were hard to come by, and the court held that specific performance was a proper remedy since a new car “could not be obtained elsewhere except at considerable expense, trouble or loss, which cannot be estimated in advance.”

We are satisfied that Laclede has brought itself within this practical approach taken by the Missouri courts. As Amoco points out, Laclede has propane immediately available to it under other contracts with other suppliers. And the evidence indicates that at the present time propane is readily available on the open market. However, this analysis ignores the fact that the contract involved in this lawsuit is for a long-term supply of propane to these subdivisions. The other two contracts under which Laclede obtains the gas will remain in force only until March 31, 1977, and April 1, 1981, respectively; and there is no assurance that Laclede will be able to receive any propane under them after that time. Also it is unclear as to whether or not Laclede can use the propane obtained under these contracts to supply the Jefferson County subdivisions, since they were originally entered into to provide Laclede with propane with which to “shave” its natural gas supply during peak demand periods.¹⁰ Additionally, there was uncontradicted expert testimony that Laclede probably could not find another supplier of propane willing to enter into a long-term contract such as the Amoco agreement, given the uncertain future of worldwide energy supplies. And, even if Laclede could obtain supplies of propane for the affected developments through its present contracts or newly negotiated ones, it would still face considerable expense and trouble which cannot be estimated in advance in making arrangements for its distribution to the subdivisions.

Specific performance is the proper remedy in this situation, and it should be granted by the district court.

For the foregoing reasons the judgment of the district court is reversed and the cause is remanded for the fashioning of appropriate injunctive relief in the form of a decree of specific performance[.]

Review Question 2. Propane is both tangible and moveable, making it “goods” (UCC § 2-105(1)). The sale of goods, of course, is governed by Article 2 of the Uniform Commercial Code. UCC section 2-716(1) provides that specific performance by a seller “may be decreed where the goods are unique or in other proper circumstances.” Is propane “unique” in any way? Assuming that it is not, what exactly qualified as the

¹⁰ [By the court] During periods of cold weather, when demand is high, Laclede does not receive enough natural gas to meet all this demand. It, therefore, adds propane to the natural gas it places in its distribution system. This practice is called “peak shaving.”

“other proper circumstances” that allowed for specific performance in the *Laclede Gas* case? If you represented Amoco, what arguments might you make that money damages actually *are* an adequate remedy for Leclde?

B. Liquidated Damages

TRUCK RENT-A-CENTER, INC. v. PURITAN FARMS 2nd, INC.

Court of Appeals of New York
41 N.Y.2d 420, 393 N.Y.S.2d 365 (1977)

JASEN, Judge.

The principal issue on this appeal is whether a provision in a truck lease agreement which requires the payment of a specified amount of money to the lessor in the event of the lessee’s breach is an enforceable liquidated damages clause, or, instead, provides for an unenforceable penalty.

Defendant Puritan Farms 2nd, Inc. (Puritan), was in the business of furnishing milk and milk products to customers through home delivery. In January, 1969, Puritan leased a fleet of 25 new milk delivery trucks from plaintiff Truck Rent-A-Center for a term of seven years commencing January 15, 1970. Under the provisions of a truck lease and service agreement entered into by the parties, the plaintiff was to supply the trucks and make all necessary repairs. Puritan was to pay an agreed upon weekly rental fee. It was understood that the lessor would finance the purchase of the trucks through a bank, paying the prime rate of interest on the date of the loan plus 2%. The rental charges on the trucks were to be adjusted in the event of a fluctuation in the interest rate above or below specified levels. The lessee was granted the right to purchase the trucks, at any time after 12 months following commencement of the lease, by paying to the lessor the amount then due and owing on the bank loan, plus an additional \$100 per truck purchased.

Article 16 of the lease agreement provided that if the agreement should terminate prior to expiration of the term of the lease as a result of the lessee’s breach, the lessor would be entitled to damages, “liquidated for all purposes,” in the amount of all rentals that would have come due from the date of termination to the date of normal expiration of the term less the “re-rental value” of the vehicles, which was set at 50% of the rentals that would have become due. In effect, the lessee would be obligated to pay the lessor, as a consequence of breach, one half of all rentals that would have become due had the agreement run its full course. The agreement recited that, in arriving at the settled amount of damage, “the parties hereto have considered, among other factors, Lessor’s substantial initial investment in purchasing or reconditioning for Lessee’s service the demised motor vehicles, the uncertainty of

Lessor's ability to re-enter the said vehicles, the costs to Lessor during any period the vehicles may remain idle until re-rented, or if sold, the uncertainty of the sales price and its possible attendant loss. The parties have also considered, among other factors, in so liquidating the said damages, Lessor's saving in expenditures for gasoline, oil and other service items."

The bulk of the written agreement was derived from a printed form lease which the parties modified by both filling in blank spaces and typing in alterations. The agreement also contained several typewritten indorsements which also made changes in the provisions of the printed lease. The provision for lessee's purchase of the vehicles for the bank loan balance and \$100 per vehicle was contained in one such indorsement. The liquidated damages clause was contained in the body of the printed form.

Puritan tendered plaintiff a security deposit, consisting of four weeks' rent and the lease went into effect. After nearly three years, the lessee sought to terminate the lease agreement. On December 7, 1973, Puritan wrote to the lessor complaining that the lessor had not repaired and maintained the trucks as provided in the lease agreement. Puritan stated that it had "repeatedly notified" plaintiff of these defaults, but plaintiff had not cured them. Puritan, therefore, exercised its right to terminate the agreement "without any penalty and without purchasing the trucks." On the date set for termination, December 14, 1973, plaintiff's attorneys replied to Puritan by letter to advise it that plaintiff believed it had fully performed its obligations under the lease and, in the event Puritan adhered to the announced breach, would commence proceedings to obtain the liquidated damages provided for in article 16 of the agreement. Nevertheless, Puritan had its drivers return the trucks to plaintiff's premises, where the bulk of them have remained ever since. At the time of termination, plaintiff owed \$45,134.17 on the outstanding bank loan.

Plaintiff followed through on its promise to commence an action for the payment of the liquidated damages. Defendant counterclaimed for the return of its security deposit. At the nonjury trial, plaintiff contended that it had fully performed its obligations to maintain and repair the trucks. Moreover, it was submitted, Puritan sought to cancel the lease because corporations allied with Puritan had acquired the assets, including delivery trucks, of other dairies and Puritan believed it cheaper to utilize this "shadow fleet." The home milk delivery business was on the decline and plaintiff's president testified that efforts to either re-rent or sell the truck fleet to other dairies had not been successful. Even with modifications in the trucks, such as the removal of the milk racks and a change in the floor of the trucks, it was not possible to lease the trucks to other industries, although a few trucks were subsequently sold. The proceeds of the sales were applied to the reduction of the bank balance. The other trucks remained at plaintiff's premises, partially protected by a

fence plaintiff erected to discourage vandals. The defendant countered with proof that plaintiff had not repaired the trucks promptly and satisfactorily.

At the close of the trial, the court found, based on the evidence it found to be credible, that plaintiff had substantially performed its obligations under the lease and that defendant was not justified in terminating the agreement. Further, the court held that the provision for liquidated damages was reasonable and represented a fair estimate of actual damages which would be difficult to ascertain precisely. “The parties, at the time the agreement was entered into, considered many factors affecting damages, namely: the uncertainty of the plaintiff’s ability to re-rent the said vehicles; the plaintiff’s investment in purchasing and reconditioning the vehicles to suit the defendant’s particular purpose; the number of man hours not utilized in the non-service of the vehicles in the event of a breach; the uncertainty of reselling the vehicles in question; the uncertainty of the plaintiff’s savings or expenditures for gasoline, oil or other service items, and the amount of fluctuating interest on the bank loan.” The court calculated that plaintiff would have been entitled to \$177,355.20 in rent for the period remaining in the lease and, in accordance with the liquidated damages provision, awarded plaintiff half that amount, \$88,677.60. The resulting judgment was affirmed by the Appellate Division, with two Justices dissenting.

The primary issue before us is whether the “liquidated damages” provision is enforceable. Liquidated damages constitute the compensation which, the parties have agreed, should be paid in order to satisfy any loss or injury flowing from a breach of their contract. In effect, a liquidated damage provision is an estimate, made by the parties at the time they enter into their agreement, of the extent of the injury that would be sustained as a result of breach of the agreement. 5 WILLISTON, CONTRACTS (3d ed.), § 776, p. 668. Parties to a contract have the right to agree to such clauses, provided that the clause is neither unconscionable nor contrary to public policy. Provisions for liquidated damage have value in those situations where it would be difficult, if not actually impossible, to calculate the amount of actual damage. In such cases, the contracting parties may agree between themselves as to the amount of damages to be paid upon breach rather than leaving that amount to the calculation of a court or jury.

On the other hand, liquidated damage provisions will not be enforced if it is against public policy to do so and public policy is firmly set against the imposition of penalties or forfeitures for which there is no statutory authority. It is plain that a provision which requires, in the event of contractual breach, the payment of a sum of money grossly disproportionate to the amount of actual damages provides for penalty and is unenforceable. *E.g., Equitable Lumber. Corp. v. IPA Land Dev. Corp.*, 381 N.Y.S.2d 459, 462-463 (1976). A liquidated damage provision has its basis in the principle of just compensation for loss. *Cf.* [First] Restatement, Contracts, § 339, and Comment. A clause which provides for an amount plainly disproportionate to real damage is not intended to provide fair compensation but to secure performance by

the compulsion of the very disproportion. A promisor would be compelled, out of fear of economic devastation, to continue performance and his promisee, in the event of default, would reap a windfall well above actual harm sustained. As was stated eloquently long ago, to permit parties, in their unbridled discretion, to utilize penalties as damages, “would lead to the most terrible oppression in pecuniary dealings.” *Hoag v. McGinnis*, 22 Wend. 163, 166 (N.Y. 1839).

The rule is now well established. A contractual provision fixing damages in the event of breach will be sustained if the amount liquidated bears a reasonable proportion to the probable loss and the amount of actual loss is incapable or difficult of precise estimation. *City of Rye v. Public Serv. Mut. Ins. Co.*, 34 N.Y.2d 470, 473, 358 N.Y.S.2d 391; [First] Restatement, Contracts, § 339.¹¹ If, however, the amount fixed is plainly or grossly disproportionate to the probable loss, the provision calls for a penalty and will not be enforced. *Equitable Lumber Co.*, 38 N.Y.2d 516, 521-522, 381 N.Y.S.2d 459, 461-462. In interpreting a provision fixing damages, it is not material whether the parties themselves have chosen to call the provision one for “liquidated damages,” as in this case, or have styled it as a penalty. Such an approach would put too much faith in form and too little in substance. Similarly, the agreement should be interpreted as of the date of its making and not as of the date of its breach.

In applying these principles to the case before us, we conclude that the amount stipulated by the parties as damages bears a reasonable relation to the amount of probable actual harm and is not a penalty. Hence, the provision is enforceable and the order of the Appellate Division should be affirmed.

Looking forward from the date of the lease, the parties could reasonably conclude, as they did, that there might not be an actual market for the sale or re-rental of these specialized vehicles in the event of the lessee’s breach. To be sure, plaintiff’s lost profit could readily be measured by the amount of the weekly rental fee. However, it was permissible for the parties, in advance, to agree that the re-rental or sale value of the vehicles would be 50% of the weekly rental. Since there was uncertainty as to whether the trucks could be re-rented or sold, the parties could reasonably set, as they did, the value of such mitigation at 50% of the amount the lessee was obligated to pay for rental of the trucks. This would take into consideration the fact that, after being used by the lessee, the vehicles would no longer be “shiny, new trucks,” but would be used, possibly battered, trucks, whose value would have declined appreciably. The parties also considered the fact that, although plaintiff, in the event of Puritan’s breach, might be spared repair and maintenance costs necessitated by Puritan’s use of the trucks, plaintiff would have to assume the cost of storing and maintaining trucks idled by Puritan’s refusal to use them. Further, it was

¹¹ [The substantially similar provision in the Restatement (Second) of Contracts is located in section 356.—Eds.]

by no means certain, at the time of the contract, that lessee would peacefully return the trucks to the lessor after lessee had breached the contract.

We attach no significance to the fact that the liquidated damages clause appears on the preprinted form portion of the agreement. The agreement was fully negotiated and the provisions of the form, in many other respects, were amended. There is no indication of any disparity of bargaining power or of unconscionability. The provision for liquidated damages related reasonably to potential harm that was difficult to estimate and did not constitute a disguised penalty. We also find no merit in the claim of trial error advanced by Puritan.

Accordingly, the order of the Appellate Division should be affirmed, with costs.

Review Question 3. The *Truck Rent-a-Center* court approvingly quotes a statement that “to permit parties, in their unbridled discretion, to utilize penalties as damages, ‘would lead to the most terrible oppression in pecuniary dealings.’” Why might that be true? Is the problem significant enough to justify the restriction on parties’ rights to contract freely for liquidated damages?

Review Question 4. Section 355 of the Restatement (Second) of Contracts articulates the longstanding rule in contract law that “[p]unitive damages are not recoverable for breach of contract unless the conduct constituting the breach is also a tort for which punitive damages are recoverable.” How does the prohibition on unreasonable liquidated damages help support the prohibition on punitive damages? Put another way, what policy determinations do both of these rules have in common?

LAKE RIVER CORPORATION v. CARBORUNDUM COMPANY

United States Court of Appeals, Seventh Circuit
769 F.2d 1284 (7th Cir. 1985).

POSNER, Circuit Judge.

This diversity suit between Lake River Corporation and Carborundum Company requires us to consider questions of Illinois commercial law, and in particular to explore the fuzzy line between penalty clauses and liquidated-damages clauses.

Carborundum manufactures “Ferro Carbo,” an abrasive powder used in making steel. To serve its midwestern customers better, Carborundum made a contract with Lake River by which the latter agreed to provide distribution services in its warehouse in Illinois. Lake River would receive Ferro Carbo in bulk from Carborundum, “bag” it, and ship the bagged product to Carborundum’s customers.

The Ferro Carbo would remain Carborundum's property until delivered to the customers.

Carborundum insisted that Lake River install a new bagging system to handle the contract. In order to be sure of being able to recover the cost of the new system (\$89,000) and make a profit of 20 percent of the contract price, Lake River insisted on the following minimum-quantity guarantee:

In consideration of the special equipment [i.e., the new bagging system] to be acquired and furnished by LAKE-RIVER for handling the product, CARBORUNDUM shall, during the initial three-year term of this Agreement, ship to LAKE-RIVER for bagging a minimum quantity of [22,500 tons]. If, at the end of the three-year term, this minimum quantity shall not have been shipped, LAKE-RIVER shall invoice CARBORUNDUM at the then prevailing rates for the difference between the quantity bagged and the minimum guaranteed.

If Carborundum had shipped the full minimum quantity that it guaranteed, it would have owed Lake River roughly \$533,000 under the contract.

After the contract was signed in 1979, the demand for domestic steel, and with it the demand for Ferro Carbo, plummeted, and Carborundum failed to ship the guaranteed amount. When the contract expired late in 1982, Carborundum had shipped only 12,000 of the 22,500 tons it had guaranteed. Lake River had bagged the 12,000 tons and had billed Carborundum for this bagging, and Carborundum had paid, but by virtue of the formula in the minimum-guarantee clause Carborundum still owed Lake River \$241,000—the contract price of \$533,000 if the full amount of Ferro Carbo had been shipped, minus what Carborundum had paid for the bagging of the quantity it had shipped.

When Lake River demanded payment of this amount, Carborundum refused, on the ground that the formula imposed a penalty. At the time, Lake River had in its warehouse 500 tons of bagged Ferro Carbo, having a market value of \$269,000, which it refused to release unless Carborundum paid the \$241,000 due under the formula. Lake River did offer to sell the bagged product and place the proceeds in escrow until its dispute with Carborundum over the enforceability of the formula was resolved, but Carborundum rejected the offer and trucked in bagged Ferro Carbo from the East to serve its customers in Illinois, at an additional cost of \$31,000.

Lake River brought this suit for \$241,000, which it claims as liquidated damages. Carborundum counterclaimed for the value of the bagged Ferro Carbo when Lake River impounded it and the additional cost of serving the customers affected by the impounding.

[The court first determines Lake River did not have a legal basis to assert a pre-judgment lien on the bagged Ferro Carbo it had impounded. Thus, Lake River

cannot use that method of self-help to collect on its claimed damages before they are reduced to final judgment. The court then turns to Lake River's liquidated damages claim.]

The hardest issue in the case is whether the formula in the minimum-guarantee clause imposes a penalty for breach of contract or is merely an effort to liquidate damages. Deep as the hostility to penalty clauses runs in the common law, see Loyd, *Penalties and Forfeitures*, 29 HARV. L. REV. 117 (1915), we still might be inclined to question, if we thought ourselves free to do so, whether a modern court should refuse to enforce a penalty clause where the signator is a substantial corporation, well able to avoid improvident commitments. Penalty clauses provide an earnest of performance. The clause here enhanced Carborundum's credibility in promising to ship the minimum amount guaranteed by showing that it was willing to pay the full contract price even if it failed to ship anything. On the other side it can be pointed out that by raising the cost of a breach of contract to the contract breaker, a penalty clause increases the risk to his other creditors; increases (what is the same thing and more, because bankruptcy imposes "deadweight" social costs) the risk of bankruptcy; and could amplify the business cycle by increasing the number of bankruptcies in bad times, which is when contracts are most likely to be broken. But since little effort is made to prevent businessmen from assuming risks, these reasons are no better than makeweights.

A better argument is that a penalty clause may discourage efficient as well as inefficient breaches of contract. Suppose a breach would cost the promisee \$12,000 in actual damages but would yield the promisor \$20,000 in additional profits. Then there would be a net social gain from breach. After being fully compensated for his loss the promisee would be no worse off than if the contract had been performed, while the promisor would be better off by \$8,000. But now suppose the contract contains a penalty clause under which the promisor if he breaks his promise must pay the promisee \$25,000. The promisor will be discouraged from breaking the contract, since \$25,000, the penalty, is greater than \$20,000, the profits of the breach; and a transaction that would have increased value will be forgone.

On this view, since compensatory damages should be sufficient to deter inefficient breaches (that is, breaches that cost the victim more than the gain to the contract breaker), penal damages could have no effect other than to deter some efficient breaches. But this overlooks the earlier point that the willingness to agree to a penalty clause is a way of making the promisor and his promise credible and may therefore be essential to inducing some value-maximizing contracts to be made. It also overlooks the more important point that the parties (always assuming they are fully competent) will, in deciding whether to include a penalty clause in their contract, weigh the gains against the costs—costs that include the possibility of discouraging an efficient breach somewhere down the road—and will include the clause only if the benefits exceed those costs as well as all other costs.

On this view the refusal to enforce penalty clauses is (at best) paternalistic—and it seems odd that courts should display parental solicitude for large corporations. But however this may be, we must be on guard to avoid importing our own ideas of sound public policy into an area where our proper judicial role is more than usually deferential. The responsibility for making innovations in the common law of Illinois rests with the courts of Illinois, and not with the federal courts in Illinois. And like every other state, Illinois, untroubled by academic skepticism of the wisdom of refusing to enforce penalty clauses against sophisticated promisors, *see, e.g.*, Goetz & Scott, *Liquidated Damages, Penalties and the Just Compensation Principle*, 77 COLUM. L. REV. 554 (1977), continues steadfastly to insist on the distinction between penalties and liquidated damages. To be valid under Illinois law a liquidation of damages must be a reasonable estimate at the time of contracting of the likely damages from breach, and the need for estimation at that time must be shown by reference to the likely difficulty of measuring the actual damages from a breach of contract after the breach occurs. If damages would be easy to determine then, or if the estimate greatly exceeds a reasonable upper estimate of what the damages are likely to be, it is a penalty.

The distinction between a penalty and liquidated damages is not an easy one to draw in practice but we are required to draw it and can give only limited weight to the district court's determination. Whether a provision for damages is a penalty clause or a liquidated-damages clause is a question of law rather than fact[.]

Mindful that Illinois courts resolve doubtful cases in favor of classification as a penalty, we conclude that the damage formula in this case is a penalty and not a liquidation of damages, because it is designed always to assure Lake River more than its actual damages. The formula—full contract price minus the amount already invoiced to Carborundum—is invariant to the gravity of the breach. When a contract specifies a single sum in damages for any and all breaches even though it is apparent that all are not of the same gravity, the specification is not a reasonable effort to estimate damages; and when in addition the fixed sum greatly exceeds the actual damages likely to be inflicted by a minor breach, its character as a penalty becomes unmistakable. *See Arduini v. Board of Educ.*, 93 Ill. App.3d 925, 931–33, 49 Ill. Dec. 460, 465–66, 418 N.E.2d 104, 109–10 (1981), *rev'd on other grounds*, 92 Ill.2d 197, 65 Ill. Dec. 281, 441 N.E.2d 73 (1982); 5 CORBIN ON CONTRACTS § 1066 (1964). This case is within the gravitational field of these principles even though the minimum-guarantee clause does not fix a single sum as damages.

Suppose to begin with that the breach occurs the day after Lake River buys its new bagging system for \$89,000 and before Carborundum ships any Ferro Carbo. Carborundum would owe Lake River \$533,000. Since Lake River would have incurred at that point a total cost of only \$89,000, its net gain from the breach would be \$444,000. This is more than four times the profit of \$107,000 (20 percent of the

contract price of \$533,000) that Lake River expected to make from the contract if it had been performed: a huge windfall.

Next suppose (as actually happened here) that breach occurs when 55 percent of the Ferro Carbo has been shipped. Lake River would already have received \$293,000 from Carborundum. To see what its costs then would have been (as estimated at the time of contracting), first subtract Lake River's anticipated profit on the contract of \$107,000 from the total contract price of \$533,000. The difference—Lake River's total cost of performance—is \$426,000. Of this, \$89,000 is the cost of the new bagging system, a fixed cost. The rest (\$426,000–\$89,000 = \$337,000) presumably consists of variable costs that are roughly proportional to the amount of Ferro Carbo bagged; there is no indication of any other fixed costs. Assume, therefore, that if Lake River bagged 55 percent of the contractually agreed quantity, it incurred in doing so 55 percent of its variable costs, or \$185,000. When this is added to the cost of the new bagging system, assumed for the moment to be worthless except in connection with the contract, the total cost of performance to Lake River is \$274,000. Hence a breach that occurred after 55 percent of contractual performance was complete would be expected to yield Lake River a modest profit of \$19,000 (\$293,000–\$274,000). But now add the “liquidated damages” of \$241,000 that Lake River claims, and the result is a total gain from the breach of \$260,000, which is almost two and a half times the profit that Lake River expected to gain if there was no breach. And this ignores any use value or salvage value of the new bagging system, which is the property of Lake River—though admittedly it also ignores the time value of money; Lake River paid \$89,000 for that system before receiving any revenue from the contract.

To complete the picture, assume that the breach had not occurred till performance was 90 percent complete. Then the “liquidated damages” clause would not be so one-sided, but it would be one-sided. Carborundum would have paid \$480,000 for bagging. Against this, Lake River would have incurred its fixed cost of \$89,000 plus 90 percent of its variable costs of \$337,000, or \$303,000. Its total costs would thus be \$392,000, and its net profit \$88,000. But on top of this it would be entitled to “liquidated damages” of \$53,000, for a total profit of \$141,000—more than 30 percent more than its expected profit of \$107,000 if there was no breach.

The reason for these results is that most of the costs to Lake River of performing the contract are saved if the contract is broken, and this saving is not reflected in the damage formula. As a result, at whatever point in the life of the contract a breach occurs, the damage formula gives Lake River more than its lost profits from the breach—dramatically more if the breach occurs at the beginning of the contract; tapering off at the end, it is true. Still, over the interval between the beginning of Lake River's performance and nearly the end, the clause could be expected to generate profits ranging from 400 percent of the expected contract profits to 130 percent of those profits. And this is on the assumption that the bagging system

has no value apart from the contract. If it were worth only \$20,000 to Lake River, the range would be 434 percent to 150 percent.

Lake River argues that it would never get as much as the formula suggests, because it would be required to mitigate its damages. This is a dubious argument on several grounds. First, mitigation 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. It would seem therefore that the clause in this case should be read to eliminate any duty of mitigation, that what Lake River is doing is attempting to rewrite the clause to make it more reasonable, and that since actually the clause is designed to give Lake River the full damages it would incur from breach (and more) even if it made no effort to find a substitute use for the equipment that it bought to perform the contract, this is just one more piece of evidence that it is a penalty clause rather than a liquidated-damages clause.

But in any event mitigation would not mitigate the penal character of this clause. If Carborundum did not ship the guaranteed minimum quantity, the reason was likely to be—the reason was—that the steel industry had fallen on hard times and the demand for Ferro Carbo was therefore down. In these circumstances Lake River would have little prospect of finding a substitute contract that would yield it significant profits to set off against the full contract price, which is the method by which it proposes to take account of mitigation. At argument Lake River suggested that it might at least have been able to sell the new bagging equipment to someone for something, and the figure \$40,000 was proposed. If the breach occurred on the first day when performance under the contract was due and Lake River promptly sold the bagging equipment for \$40,000, its liquidated damages would fall to \$493,000. But by the same token its costs would fall to \$49,000. Its profit would still be \$444,000, which as we said was more than 400 percent of its expected profit on the contract. The penal component would be unaffected.

With the penalty clause in this case compare the liquidated-damages clause in *Arduini v. Board of Education*, supra, which is representative of such clauses upheld in Illinois. The plaintiff was a public school teacher whose contract provided that if he resigned before the end of the school year he would be docked 4 percent of his salary. This was a modest fraction of the contract price. And the cost to the school of an untimely resignation would be difficult to measure. Since that cost would be greater the more senior and experienced the teacher was, the fact that the liquidated damages would be greater the higher the teacher's salary did not make the clause arbitrary. Even the fact that the liquidated damages were the same whether the

teacher resigned at the beginning, the middle, or the end of the school year was not arbitrary, for it was unclear how the amount of actual damages would vary with the time of resignation. Although one might think that the earlier the teacher resigned the greater the damage to the school would be, the school might find it easier to hire a replacement for the whole year or a great part of it than to bring in a replacement at the last minute to grade the exams left behind by the resigning teacher. Here, in contrast, it is apparent from the face of the contract that the damages provided for by the “liquidated damages” clause are grossly disproportionate to any probable loss and penalize some breaches much more heavily than others regardless of relative cost.

We do not mean by this discussion to cast a cloud of doubt over the “take or pay” clauses that are a common feature of contracts between natural gas pipeline companies and their customers. Such clauses require the customer, in consideration of the pipeline’s extending its line to his premises, to take a certain amount of gas at a specified price—and if he fails to take it to pay the full price anyway. The resemblance to the minimum-guarantee clause in the present case is obvious, but perhaps quite superficial. Neither party has mentioned take-or-pay clauses, and we can find no case where such a clause was even challenged as a penalty clause—though in one case it was argued that such a clause made the damages unreasonably low. See *National Fuel Gas Distribution Corp. v. Pennsylvania Public Utility Comm’n*, 76 Pa. Commw. 102, 126–27 n. 8, 464 A.2d 546, 558 n. 8 (1983). If, as appears not to be the case here but would often be the case in supplying natural gas, a supplier’s fixed costs were a very large fraction of his total costs, a take-or-pay clause might well be a reasonable liquidation of damages. In the limit, if all the supplier’s costs were incurred before he began supplying the customer, the contract revenues would be an excellent measure of the damages from breach. But in this case, the supplier (Lake River, viewed as a supplier of bagging services to Carborundum) incurred only a fraction of its costs before performance began, and the interruption of performance generated a considerable cost saving that is not reflected in the damage formula.

The fact that the damage formula is invalid does not deprive Lake River of a remedy. The parties did not contract explicitly with reference to the measure of damages if the agreed-on damage formula was invalidated, but all this means is that the victim of the breach is entitled to his common law damages. See, e.g., Restatement, Second, Contracts § 356, comment a (1981). In this case that would be the unpaid contract price of \$241,000 minus the costs that Lake River saved by not having to complete the contract (the variable costs on the other 45 percent of the Ferro Carbo that it never had to bag). The case must be remanded to the district judge to fix these damages.

Review Question 5. What facts made the liquidated damages provision in *Lake River* an unenforceable penalty while its counterpart in *Truck Rent-a-Center* was enforced? You may have to re-read the case carefully to answer this question with an acceptable level of specificity.

Review Question 6. Judge Posner says in *Lake River* that one strong argument against enforcing punitive liquidated damages provisions is that “a penalty clause may discourage efficient as well as inefficient breaches of contract.” What exactly are “efficient” breaches of contract and why would a legal system not want to discourage them? In what kind of factual scenario could you imagine breaching a contract being a net social benefit in a way that, say, commission of a tort is not?

Problems

Problem 26.1

Sandra Perez owns the 8th Avenue Grill, a lunch-and-breakfast restaurant occupying 1500 square feet on the ground floor of Anderson Tower, a twenty-story office building located a few blocks outside the downtown business district. In 20X5, Perez is in the fifth year of a nine-year lease with Anderson LLP, the owner of the building. During Perez’s five years in business, slightly more than half of the customers of 8th Avenue Grill have been office tenants who work in Anderson Tower. The building has never been more than 75% occupied during that time, and in recent years, Anderson LLP has lost money or barely broken even. Starting in mid-20X5, Anderson LLP began systematically not renewing the leases of its office tenants (who have much shorter-term leases than the ground floor restaurant), which seemed like odd behavior for a landlord. By September, however, Anderson’s reasons for removing tenants became clear as it announced a plan to convert the building from office space to expensive downtown condominiums.

Perez is devastated by this announcement, as it means her breakfast and lunch clientele will dwindle and her business will almost certainly fail. That failure, incidentally, is precisely the outcome hoped for by the landlord, who wants to convert the 8th Avenue Grill space into a posh lobby for the new condominiums. Upon examination of her lease, however, Perez notices that Anderson LLP explicitly promised to lease to her “1500 square feet on the ground floor of this twenty-story *office building*,” not a condominium. Perez decides to sue Anderson LLP, and her lawyer quickly obtains a partial summary judgment determining that the landlord is

breaching its lease with Perez by the act of converting Anderson Tower into condominiums.

Perez deeply wants to keep the 8th Avenue Grill and life as she knows it intact for the remaining four years on her lease before she retires. Can Perez obtain a decree of specific performance requiring Anderson LLP to perform its contractual obligation to lease space in Anderson Towers as an office building for four more years? What will both sides argue and who should prevail?

Problem 26.2

In March, retail chain Toys-We-Is signed a contract with PlayCo, a home playground equipment manufacturer. The contract provides for PlayCo to ship Toys-We-Is 1,000 of its exclusively licensed Space Trek Wars play forts at \$10,000 each, for delivery on November 1. Toys-We-Is originally planned, in turn, to sell the play forts for \$15,000 at retail. In July, however, a new installment in the Space Trek Wars movie franchise releases and it becomes a massive hit, increasing the demand for products associated with Space Trek Wars. Sensing an opportunity, Toys-We-Is launched an ad campaign built around these elaborate sci-fi themed play forts, which it now plans to sell for \$20,000 as all indications are that the forts will be a high-end “it” toy for the holiday season.

On October 1, PlayCo informs Toys-We-Is that it is breaching the contract and will not deliver any of the forts. The real reason for this breach, it turns out, is that PlayCo decided it could sell the forts to the public itself through its website and reap all the profit. The president of Toys-We-Is, Latoya Ball, has come to your office about the situation. Ball says that while losing profit on the forts is bad enough, her greater concern is with the loss of reputation for the Toys-We-Is chain, which has built its entire marketing plan around Space Trek Wars and these play forts as the “crown jewel” product. Many customers would be drawn into the stores to gawk at the floor model, even though few will purchase it. That sort of foot traffic (especially parents with children) drives holiday sales. Ball wants to know if she can force PlayCo to honor its agreement with Toys-We-Is. Can she? Make sure your answer addresses UCC § 2-716 and its Official Comments 1 and 2.

Problem 26.3

In April 20X0, ex-NBA player Carlisle Richards and regional school Kings State University (“KSU”) executed an employment agreement making Richards the head men’s basketball coach at KSU for a period of four years with an option for a fifth year. The contract contained a liquidated damages provision that states:

Richards recognizes that his promise to work for the University for the entire term of this contract is of the

essence of this contract with the University. Richards also recognizes that the University is making a highly valuable investment in his continued employment by entering into this contract and its investment would be lost were he to resign or otherwise terminate his employment with the University prior to the expiration of this Contract. Accordingly, he will pay to the University as liquidated damages an amount equal to his base and supplemental salary, multiplied by the number of years (or portion(s) thereof) remaining on the contract.

Richards was highly successful in his first two seasons at KSU, both years reaching the “Sweet 16” semifinals in the NCAA Tournament. In April 20X2, at the coach’s request, Richards and Kings State renegotiated and executed a modified employment agreement for a term of five years that increased his salary and supplemental salary by a total of \$100,000.00 for a total annual salary of \$300,000.00. The liquidated damages clause in the modified agreement was identical to the original version.

In March 20X3, Richards led his team even further, to the NCAA “Final Four.” A few days after KSU’s elimination by the eventual national champion, Richards quit his position at KSU and accepted the same position at Behemoth State University—a much larger and more prestigious school—for a total annual salary of \$700,000.00. KSU promptly sued Richards, claiming liquidated damages of \$1,200,000. What will both sides argue and who should prevail?



**AMERICAN CONTRACT LAW
FOR A GLOBAL AGE**

**Chapter IX: Contract
Nonparties**

Unit 27: Third-Party Beneficiaries

Unit 28: Assignment and Delegation

An Introduction to CONTRACT NONPARTIES

Are We Not Done Yet?! If you have proceeded through the previous units in this book, you have gone through every step of the contract process.

- What law applies—common law, UCC, CISG, or something else?
- Was there an agreement between the parties?
- If so, is the agreement supported by consideration or some substitute?
- If so, is there some defense to the formation of the contract?
- If not, have we interpreted the agreement and determined that what each party was supposed to have done?
- If so, did one of the parties breach?
- If so, was the breach excused?
- If not, what remedies are available to party victimized by the breach?

But there is, in fact, one more type of issues that may arise and that we should address. So far in all of our discussions we have assumed that the party raising the claim of breach was a party to the contract. And that is by far the most common situation.

Strangers to the Contract. Indeed, the general rule in contract law is that a “stranger to the contract” (that is, one who is not a party) has no right to enforce the contract. After all, contracts often are not isolated transactions, and many people may have some generalized “interest” in the contracts. In some cases, like a contract between a star athlete and a professional team, there may be literally millions of fans with an interest in how one or both of the parties are performing the contract. Imagine the chaos if *anyone* interested in whether a contract is performed could bring a lawsuit. Even if we limit litigation rights to non-parties who actually have a direct economic interest riding on the transaction, strong reasons still exist to restrict the right to bring claims to the parties themselves. Suppose, for example that Tracy is married to Dana, and Dana has a lucrative employment contract with her employer. The employer breaches the contract and fires Dana. Tracy obviously has suffered harm—where spouses share incomes the loss of one hurts both. If Dana does not want to sue the employer, can Tracy sue for the harm that *he* suffered?

Generally, the answer to that question is “no.” The long-standing doctrine of “privity of contract” holds that when parties create a contract, it benefits and binds only themselves. They cannot impose contractual obligations on those who are not

parties, and only they can enforce the obligations they have undertaken through a breach of contract claim.

Enter the Outsiders. Privity is still a basic principle of contract law, but there are two very important areas where nonparties *do* have the right to bring actions in their own name. One area involves the concept of *assignment and delegation*, where parties transfer their rights and obligations to others, effectively allowing new parties to be substituted for original parties. The second area is the doctrine of *third party beneficiaries*, in which the original contracting parties remain, but enforceable rights have been created for nonparties. These concepts are the subjects of the next two units.

Unit 27: Third-Party Beneficiaries

CONTRACT NONPARTIES

Part One

FOCUS OF THIS UNIT

Consider the common life insurance policy. Suppose that Mario has purchased life insurance from Mushroom Mutual Insurance Company. As part of the purchase, Mario has designated Peach as his beneficiary. Peach may not know anything about this contract until long after its making, but both Mario and Mushroom Mutual understand that the purpose of the contract is to make a payment to Peach in the event of Mario's demise during the term of the policy. Suppose Mario dies and Mutual does not pay the policy amount. The late Mario cannot sue because he is (still) dead. Can Peach—who was not a party to the contract—sue Mutual? The answer, as you probably suspect, is going to be yes. After all, it would make no sense to have a life insurance policy that could not be enforced because the policy holder was dead. It only makes sense for Peach to have rights under the contract. The nonparty allowed to sue in such circumstances is known as a “third party beneficiary.”

Intended or Incidental? Suppose, however, that Peach does not sue for the money. But Mario's brother Luigi—to whom Peach owes a great deal of money—wants to sue Mushroom Mutual to have it pay Peach, so that Peach will have the money to pay Luigi. Can Luigi enforce the contract against Mutual? No. Luigi would benefit if the contract were performed, but he is not allowed to enforce it. As you will see from the cases below, Peach is what lawyers call an “intended beneficiary,” while Luigi is an “incidental beneficiary.” The distinction is important. If an aircraft company signs a new contract to build fifty passenger planes, a lot of people will *incidentally* benefit from the contract—employees, stockholders, subcontractors and suppliers (and *their* employees, stockholders, and suppliers), and so on. But only *intended* beneficiaries can enforce the contract.

Defenses Against Beneficiary Claims. The rights of a third-party beneficiary do not exist apart from the underlying contract between the promisor and promisee. Put differently, the third party's rights are *derivative* of the rights of the promisee. As a result, the beneficiary gets contract rights that are no greater than the promisee had. You may recall an otherwise enforceable contract is subject to defenses, such as fraud, mistake, and illegality. If the promisor in an underlying contract would have

the right to raise defenses against the promisee, those same defenses are effective against a claim brought by a third-party beneficiary. Section 309 of the Restatement (Second) of Contracts also states a useful rule that obviously follows from the nature of derivative claims: if no contract was ever formed between the promisor and the promisee, there can be no third-party beneficiary.

Cases and Materials

LAWRENCE v. FOX

Court of Appeals of New York
20 N.Y. 268 (1859)

H. GRAY, J.

[Holly owed \$300 to Lawrence. Holly then agreed to loan Fox \$300, and Fox in return Fox promised to settle Holly's debt by paying the \$300 to Lawrence. Fox failed to do so. Lawrence sued Fox. Fox argued that he was not a party to Lawrence's contract with Holly, and Lawrence was not a party to his own contract with Holly, and therefore Lawrence could not sue him.]¹

It is now more than a quarter of a century since it was settled by the Supreme Court of this State—in an able and pains-taking opinion by the late Chief Justice SAVAGE, in which the authorities were fully examined and carefully analyzed—that a promise in all material respects like the one under consideration was valid; and the judgment of that court was unanimously affirmed by the Court for the Correction of Errors. *Farley v. Cleveland*, 4 Cow. 432 (N.Y. 1825), *same case in error*, 9 Cow. 639 (N.Y. 1827). In that case one Moon owed Farley and sold to Cleveland a quantity of hay, in consideration of which Cleveland promised to pay Moon's debt to Farley; and the decision in favor of Farley's right to recover was placed upon the ground that the hay received by Cleveland from Moon was a valid consideration for Cleveland's promise to pay Farley, and that the subsisting liability of Moon to pay Farley was no objection to the recovery.

The report of that case shows that the promise was not only made to Moon but to the plaintiff Farley. In this case, the promise was made to Holly and not expressly to the plaintiff; and this difference between the two cases presents the question,

¹ [If you are wondering why Lawrence chose to sue Fox instead of the man who actually owed him the money, the best guess is that of Professor Waters, who concluded that Holly owed an illegal gambling debt to Lawrence. As you learned in the unit on illegality, courts do not enforce such agreements. Do you think Lawrence's lawyer earned his fee by prevailing in this case? For the story of the case, see Anthony J. Waters, *The Property In the Promise: A Study of the Third Party Beneficiary Rule*, 98 HARV. L. REV. 1109, 1123-1127 (1985). – Eds.]

raised by the defendant's objection, as to the want of privity between the plaintiff and defendant.

As early as 1806 it was announced by the Supreme Court of this State, upon what was then regarded as the settled law of England, "That where one person makes a promise to another for the benefit of a third person, that third person may maintain an action upon it." *Schermerhorn v. Vanderheyden*, 1 Johns. 139 (N.Y. 1806), has often been re-asserted by our courts and never departed from.

This question was subsequently, and in a case quite recent, again the subject of consideration by the Supreme Court, when it was held, that in declaring upon a promise, made to the debtor by a third party to pay the creditor of the debtor, founded upon a consideration advanced by the debtor, it was unnecessary to aver a promise to the creditor; for the reason that upon proof of a promise made to the debtor to pay the creditor, a promise to the creditor would be implied. And in support of this proposition, in no respect distinguishable from the one now under consideration, the case of *Schermerhorn v. Vanderheyden*, with many intermediate cases in our courts, were cited, in which the doctrine of that case was not only approved but affirmed. The same principle is adjudged in several cases in Massachusetts. In *Hall v. Marston*, 17 Mass. 575 (1822), the court says: "It seems to have been well settled that if *A* promises *B* for a valuable consideration to pay *C*, the latter may maintain assumpsit for the money"; and in *Brewer v. Dyer*, 61 Mass. 337 (1851), the recovery was upheld, as the court said, "upon the principle of law long recognized and clearly established, that when one person, for a valuable consideration, engages with another, by a simple contract, to do some act for the benefit of a third, the latter, who would enjoy the benefit of the act, may maintain an action for the breach of such engagement; that it does not rest upon the ground of any actual or supposed relationship between the parties as some of the earlier cases would seem to indicate, but upon the broader and more satisfactory basis, that the law operating on the act of the parties creates the duty, establishes a privity, and implies the promise and obligation on which the action is founded."

It was also insisted that Holly could have discharged the defendant from his promise, though it was intended by both parties for the benefit of the plaintiff, and therefore the plaintiff was not entitled to maintain this suit for the recovery of a demand over which he had no control. It is enough that the plaintiff did not release the defendant from his promise, and whether he could or not is a question not now necessarily involved. Suppose the defendant had given his note in which, for value received of Holly, he had promised to pay the plaintiff and the plaintiff had accepted the promise, retaining Holly's liability. Very clearly Holly could not have discharged that promise, be the right to release the defendant as it may. No one can doubt that he owes the sum of money demanded of him, or that in accordance with his promise it was his duty to have paid it to the plaintiff; nor can it be doubted that whatever may be the diversity of opinion elsewhere, the adjudications in this State, from a very

early period, approved by experience, have established the defendant's liability; if, therefore, it could be shown that a more strict and technically accurate application of the rules applied, would lead to a different result (which I by no means concede), the effort should not be made in the face of manifest justice.

The judgment should be affirmed.

COMSTOCK, J. (Dissenting.)

The plaintiff had nothing to do with the promise on which he brought this action. It was not made to him, nor did the consideration proceed from him. If he can maintain the suit, it is because an anomaly has found its way into the law on this subject. In general, there must be privity of contract. The party who sues upon a promise must be the promisee, or he must have some legal interest in the undertaking. In this case, it is plain that Holly, who loaned the money to the defendant, and to whom the promise in question was made, could at any time have claimed that it should be performed to himself personally. He had lent the money to the defendant, and at the same time directed the latter to pay the sum to the plaintiff. This direction he could countermand, and if he had done so, manifestly the defendant's promise to pay according to the direction would have ceased to exist. The plaintiff would receive a benefit by a complete execution of the arrangement, but the arrangement itself was between other parties, and was under their exclusive control. If the defendant had paid the money to Holly, his debt would have been discharged thereby. So Holly might have released the demand or assigned it to another person, or the parties might have annulled the promise now in question, and designated some other creditor of Holly as the party to whom the money should be paid. It has never been claimed, that in a case thus situated, the right of a third person to sue upon the promise rested on any sound principle of law.

Review Question 1. Judge Comstock's dissent in *Lawrence v. Fox* asserts the general principle that to bring a breach of contract claim "there must be privity of contract. The party who sues upon a promise must be the promisee, or he must have some legal interest in the undertaking." The requirement of "privity of contract" reflects the common law's longstanding position that only parties who have a direct legal relationship to the contract can enforce it. Did it make logical sense for the New York Court of Appeals to relax the privity rule under the facts of *Lawrence*? Why or why not? Would your opinion change if you concluded, like Judge Comstock did in a lengthy part of his opinion that we omitted, that no existing precedent actually supported the majority's outcome?

Review Question 2. One argument against granting Lawrence the right to sue Fox directly is that changing the law was unnecessary. Since Lawrence retained his right to sue Holly, he could do so and then place the burden on Holly to join Fox to the lawsuit as a third-party defendant and then let the court sort things out. What, if any, are the disadvantages to such an approach?

Comment. British courts until 1999 were firmly in Judge Comstock's camp—they managed to get through the entire 19th and 20th centuries without recognizing third party beneficiary doctrine, until Parliament enacted it in statutory form in The Contracts (Rights of Third Parties) Act of 1999. It took some 70 years to get the legislation passed, and even then not everyone liked it. As you read the cases in this unit, think about whether the British courts or the American courts had the better approach to these cases.

SEAVER v. RANSOM

Court of Appeals of New York
224 N.Y. 233, 120 N.E. 639 (1918)

POUND, J.

Judge Beman and his wife were advanced in years. Mrs. Beman was about to die. She had a small estate, consisting of a house and lot in Malone and little else. Judge Beman drew his wife's will according to her instructions. It gave \$1,000 to plaintiff, \$500 to one sister, plaintiff's mother, and \$100 each to another sister and her son, the use of the house to her husband for life, and remainder to the American Society for the Prevention of Cruelty to Animals. She named her husband as residuary legatee and executor. Plaintiff was her niece, 34 years old, in ill health, sometimes a member of the Beman household. When the will was read to Mrs. Beman, she said that it was not as she wanted it. She wanted to leave the house to plaintiff. She had no other objection to the will, but her strength was waning, and, although the judge offered to write another will for her, she said she was afraid she would not hold out long enough to enable her to sign it. So the judge said, if she would sign the will, he would leave plaintiff enough in his will to make up the difference. He avouched the promise by his uplifted hand with all solemnity and his wife then executed the will. When he came to die, it was found that his will made no provision for the plaintiff.

This action was brought, and plaintiff recovered judgment in the trial court, on the theory that Beman had obtained property from his wife and induced her to execute the will in the form prepared by him by his promise to give plaintiff \$6,000, the value of the house, and that thereby equity impressed his property with a trust in favor of plaintiff. Where a legatee promises the testator that he will use property given him by the will for a particular purpose, a trust arises. Beman received nothing

under his wife's will but the use of the house in Malone for life. Equity compels the application of property thus obtained to the purpose of the testator, but equity cannot so impress a trust, except on property obtained by the promise. Beman was bound by his promise, but no property was bound by it; no trust in plaintiff's favor can be spelled out.

An action on the contract for damages, or to make the executors trustees for performance, stands on different ground. The Appellate Division properly passed to the consideration of the question whether the judgment could stand upon the promise made to the wife, upon a valid consideration, for the sole benefit of plaintiff. The judgment of the trial court was affirmed by a return to the general doctrine laid down in the great case of *Lawrence v. Fox*, 20 N.Y. 268 (1859), which has since been limited as herein indicated.

Contracts for the benefit of third persons have been the prolific source of judicial and academic discussion. Williston, *Contracts for the Benefit of a Third Person*, 15 HARV. L. REV. 767; Corbin, *Contracts for the Benefit of Third Persons*, 27 YALE L. REV. 1008. The general rule, both in law and equity was that privity between a plaintiff and a defendant is necessary to the maintenance of an action on the contract. The consideration must be furnished by the party to whom the promise was made. The contract cannot be enforced against the third party, and therefore it cannot be enforced by him. On the other hand, the right of the beneficiary to sue on a contract made expressly for his benefit has been fully recognized in many American jurisdictions, either by judicial decision or by legislation, and is said to be "the prevailing rule in this country." *Hendrick v. Lindsay*, 93 U.S. 143, 23 L. Ed. 855; *Lehow v. Simonton*, 3 Colo. 346. It has been said that 'the establishment of this doctrine has been gradual, and is a victory of practical utility over theory, of equity over technical subtlety.' BRANTLY ON CONTRACTS (2d Ed.) p. 253. The reasons for this view are that it is just and practical to permit the person for whose benefit the contract is made to enforce it against one whose duty it is to pay. Other jurisdictions still adhere to the present English rule that a contract cannot be enforced by or against a person who is not a party.

In New York the right of the beneficiary to sue on contracts made for his benefit is not clearly or simply defined. It is at present confined: First, to cases where there is a pecuniary obligation running from the promisee to the beneficiary, "a legal right founded upon some obligation of the promisee in the third party to adopt and claim the promise as made for his benefit." *Farley v. Cleveland*, 4 Cow. 432, 15 Am. Dec. 387; *Lawrence v. Fox*, *supra*. Secondly, to cases where the contract is made for the benefit of the wife, affianced wife, or child of a party to the contract. The close relationship cases go back to the early King's Bench case (1677), long since repudiated in England, of *Dutton v. Poole*, 2 Lev. 211 (s. c., 1 Ventris, 318, 332). The natural and moral duty of the husband or parent to provide for the future of wife or child sustains

the action on the contract made for their benefit. 'This is the farthest the cases in this state have gone,' says Cullen, J., in the marriage settlement case of *Borland v. Welch*, 162 N. Y. 104, 110, 56 N. E. 556.

The right of the third party is also upheld in, thirdly, the public contract, where the municipality seeks to protect its inhabitants by covenants for their benefit; and, fourthly, the cases where, at the request of a party to the contract, the promise runs directly to the beneficiary although he does not furnish the consideration. It may be safely said that a general rule sustaining recovery at the suit of the third party would include but few classes of cases not included in these groups, either categorically or in principle.

The desire of the childless aunt to make provision for a beloved and favorite niece differs imperceptibly in law or in equity from the moral duty of the parent to make testamentary provision for a child. The contract was made for the plaintiff's benefit. She alone is substantially damaged by its breach. The representatives of the wife's estate have no interest in enforcing it specifically. It is said in *Buchanan v. Tilden* that the common law imposes moral and legal obligations upon the husband and the parent not measured by the necessities of life. It was, however, the love and affection or the moral sense of the husband and the parent that imposed such obligations in the cases cited, rather than any common-law duty of husband and parent to wife and child. If plaintiff had been a child of Mrs. Beman, legal obligation would have required no testamentary provision for her, yet the child could have enforced a covenant in her favor identical with the covenant of Judge Beman in this case. The constraining power of conscience is not regulated by the degree of relationship alone. The dependent or faithful niece may have a stronger claim than the affluent or unworthy son. No sensible theory of moral obligation denies arbitrarily to the former what would be conceded to the latter. We might consistently either refuse or allow the claim of both, but I cannot reconcile a decision in favor of the wife in *Buchanan v. Tilden*, based on the moral obligations arising out of near relationship, with a decision against the niece here on the ground that the relationship is too remote for equity's ken. No controlling authority depends upon so absolute a rule. . . . Kellogg, P. J., writing for the court below well said:

The doctrine of *Lawrence v. Fox* is progressive, not retrograde. The course of the late decisions is to enlarge, not to limit, the effect of that case.

The court in that leading case attempted to adopt the general doctrine that any third person, for whose direct benefit a contract was intended, could sue on it. As late as *Townsend v. Rackham*, 143 N. Y. 516, 523, 38 N. E. 731, 733, we find Peckham, J., saying that, 'to maintain the action by the third person, there must be this liability to him on the part of the promisee.' *Buchanan v. Tilden* went further than any case since *Lawrence v. Fox* in a desire to do justice rather than to apply with technical accuracy strict rules calling for a legal or equitable obligation.

But, on principle, a sound conclusion may be reached. If Mrs. Beman had left her husband the house on condition that he pay the plaintiff \$6,000, and he had accepted the devise, he would have become personally liable to pay the legacy, and plaintiff could have recovered in an action at law against him, whatever the value of the house. That would be because the testatrix had in substance bequeathed the promise to plaintiff, and not because close relationship or moral obligation sustained the contract. The distinction between an implied promise to a testator for the benefit of a third party to pay a legacy and an unqualified promise on a valuable consideration to make provision for the third party by will is discernible, but not obvious. The tendency of American authority is to sustain the gift in all such cases and to permit the donee beneficiary to recover on the contract. *Matter of Edmundson's Estate*, 103 A. 277, 259 Pa. 429 (1918). The equities are with the plaintiff, and they may be enforced in this action, whether it be regarded as an action for damages or an action for specific performance to convert the defendants into trustees for plaintiff's benefit under the agreement.

The judgment should be affirmed, with costs.

Review Question 3. In *Lawrence v. Fox*, the third-party beneficiary was a creditor, while in *Seaver v. Ransom*, the third-party beneficiary sought to enforce a promise to make a gift. The *Seaver* court states that the distinction between these two situations is “discernable, but not obvious.” As you may recall from our study of consideration, contract law often treats gift promises quite differently from other promises. Why exactly did the court decide to treat a gift promise the same way as a promise to pay a debt?

Review Question 4. In your Property course, you may have run across the general requirements for a valid will. A will is quite formal, and most states require it to be personally handwritten by the testator or signed in front of at least two witnesses who attest to the signature. Here, there were two wills (the wife's and the husband's) and neither one gave the house to the niece. Judge Pound seems to say that the formality of the requirements for wills can be circumvented simply by making an oral statement of intent. Does it make sense for parties to be able to accomplish something through contract law that the law governing wills expressly does not permit? Why or why not?

HALE v. GROCE
Supreme Court of Oregon
304 Or. 281, 744 P.2d 1289 (1987)

LINDE, Justice.

Defendant, who is an attorney, was directed by a client to prepare testamentary instruments and to include a bequest of a specified sum to plaintiff. After the client's death, it was discovered that the gift was not included either in the will or in a related trust instrument. After an unsuccessful attempt to obtain judicial reformation of the will and trust, plaintiff brought the present action for damages against the attorney.

The complaint alleged as two separate claims, first, that defendant was negligent in a number of particulars and, second, that he failed to carry out a contractual promise to his client, the decedent, which the decedent had intended specifically for the benefit of plaintiff. In other states plaintiffs in such cases have sometimes been allowed to recover on one or both of these theories, as negligently injured parties or as third-party beneficiaries under a contract. It is a new question in this court.

Defendant moved to dismiss the complaint on grounds that the stated facts did not constitute a claim under either theory, and that, at least as to the tort theory, the action was not commenced within the time limited by the applicable statute. The circuit court held that the action was not time-barred but allowed defendant's motion to dismiss both claims. On plaintiff's appeal, the Court of Appeals reinstated plaintiff's negligence claim, and it also remanded for trial her allegations that defendant was estopped from invoking the statute of limitations. *Hale v. Groce*, 730 P.2d 576 (Or. Ct. App. 1986).

Both parties petitioned this court for review. Defendant asserts that a lawyer owes a professional duty of care only to his client and cannot be sued for malpractice by others who are injured by the way he performs that duty. Plaintiff asks us to reinstate her contract claim as a third-party beneficiary. We hold that the complaint states claims for damages under both theories, a claim as the intended beneficiary of defendant's professional contract with the decedent and a derivative tort claim based on breach of the duty created by that contract to the plaintiff as its intended beneficiary.

The two claims are related, but they differ in important respects. Standing alone, without a duty to plaintiff derived from defendant's contractual undertaking, plaintiff's tort claim would confront the rule that one ordinarily is not liable for negligently causing a stranger's purely economic loss without injuring his person or property. See *Ore-Ida Foods v. Indian Head*, 627 P.2d 469 (Or. 1981) (denying employer's claim against third person who caused employer to become liable for

workers' compensation benefits), *Snow v. West*, 440 P.2d 864 (Or. 1968) (denying employer's claim against third person for loss of services of employee). It does not suffice that the harm is a foreseeable consequence of negligent conduct that may make one liable to someone else, for instance to a client. Some source of a duty outside the common law of negligence is required. Even then, tort rules such as comparative fault may apply that do not apply to contract claims. A contract claim, on the other hand, does not necessarily depend on showing negligence.

Similar claims were made in *Currey v. Butcher*, 61 P. 631 (Or. 1900), in which attorneys were charged with a faulty search of a title. This court held that they were entitled to an instruction that they would not be liable to a person for whom their client may have acted unbeknownst to them. A chief precedent for *Currey* was *Buckley v. Gray*, 42 P. 900 (Cal. 1895), which the court cited for the proposition that "an attorney employed to draw a will is not liable to a person who, through the attorney's ignorance or negligence in the discharge of his professional duties, was deprived of the portion of the estate which the testator instructed the attorney should be given such person by the will."

Since 1900, many courts have reconsidered that proposition, some preferring a contract analysis, some negligence, and at least one "a definite maybe." *Kirgan v. Parks*, 478 A.2d 713, 714 (Md. Ct. App. 1984). *Buckley v. Gray* itself was overruled in *Lucas v. Hamm*, 364 P.2d 685, 687 (Cal. 1961). The California Supreme Court stated that a lawyer might be liable to an intended testamentary beneficiary either for negligence or for breach of the lawyer's contract with the testator, though the court balked at recognizing professional negligence in a lawyer's failure to meet the state's rule against perpetuities and restraints on alienation. After *Lucas*, the California court treated contract liability as superfluous and settled on negligence theory, which in California calls for applying "public policy" by "balancing" half a dozen "factors" in each case.

The Pennsylvania Supreme Court chose the contrary course in *Guy v. Liederbach*, 459 A.2d 744 (Pa. 1983), a claim by a beneficiary who lost a legacy because the testator's lawyer let her subscribe as a witness to the will. The court rejected both open-ended tort liability to foreseeably injured third parties and what it considered the "unworkable" California standard, noting that:

although a plaintiff on a third party beneficiary theory in contract may in some cases have to show a deviation from the standard of care, as in negligence, to establish breach, the class of persons to whom the defendant may be liable is restricted by principles of contract law, not negligence principles relating to foreseeability or scope of the risk.

Id. at 752. Citing dictum in an early Pennsylvania decision, *Lawall v. Groman*, 37 A. 98 (Pa. 1897), the court settled instead on liability to the intended beneficiary under Restatement (Second) Contracts § 302(1) (1981).²

The Connecticut Supreme Court similarly allowed a disappointed beneficiary of a testamentary trust to proceed against the testatrix's lawyer on a contract theory over an objection that the lawyer's promise obligated him only to the client and not to the intended beneficiary, because the benefit to the plaintiff also was the essence of the benefit promised to the testatrix. *Stowe v. Smith*, 441 A.2d 81 (Conn. 1981).

We agree that the beneficiary in these cases is not only a plausible but a classic "intended" third-party beneficiary of the lawyer's promise to his client within the rule of Restatement § 302(1)(b) and may enforce the duty so created, as stated. *Id.* section 304.³ See, e.g., *Parker v. Jeffery*, 37 P. 712 (Ore. 1894) (stating rule that a contract may be enforced by one for whose benefit it was intended). The promise, of course, was not that the lawyer would pay plaintiff the stipulated sum, and it is too late for the lawyer to perform the promise that he did make, but this does not preclude an action for damages for the nonperformance. In principle, such an action is available to one in plaintiff's position.

Because under third-party analysis the contract creates a "duty" not only to the promisee, the client, but also to the intended beneficiary, negligent nonperformance may give rise to a negligence action as well. Not every such contract will support either claim. A contract to prepare a will or other instrument may promise different things. It may undertake to make a particular disposition by means specified by the client (for instance, in trust, or by a gift of identified property), or to accomplish the intended gift by specified means of the lawyer's choosing. Failure to do what was promised then would be a breach of contract regardless of any negligence. On the other hand, the lawyer's promise might be to use his best professional efforts to accomplish the specified result with the skill and care customary among lawyers in the relevant community. Because negligence liability of this kind arises only from the professional obligation to the client, it does not threaten

² [Section 302 provides:

(1) Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either

(a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or

(b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance.

(2) An incidental beneficiary is a beneficiary who is not an intended beneficiary. —Eds.]

³ ["A promise in a contract creates a duty in the promisor to any intended beneficiary to perform the promise, and the intended beneficiary may enforce the duty." Restatement (Second) of Contracts § 304.—Eds.]

to divide a lawyer's loyalty between the client and a potentially injured third party, as defendant argues.

Whether breach of that kind of promise is properly characterized as a breach of contract or as negligence, we have said, depends on the legal rule for which its character is at issue. See *Securities–Intermountain v. Sunset Fuel*, 289 Or. 243, 252 n.6, 611 P.2d 1158 (1980). That case, like this one, involved an issue whether the action was commenced in time. We cited *Currey v. Butcher*, *supra*, to illustrate that a breach of professional duty could give rise to an action “either in assumpsit, for a breach of the implied promise, or in case, for the neglect of the duty.” *Securities–Intermountain*, 289 Or. at 254, 611 P.2d 1158. We also noted Justice O’Connell’s observation, in *Bales for Food v. Poole*, 246 Or. 253, 424 P.2d 892 (1967), that the different statutory time limitations for tort and contract claims deserved legislative reconsideration. 289 Or. at 260, 611 P.2d 1158.

In the present case, the Court of Appeals held that plaintiff’s complaint pleaded only a tort claim. In the court’s view, the complaint alleged no more than that the alleged professional contract “merely incorporate[d] by reference or by implication a general standard of skill and care to which the defendant would be bound independent of the contract.”

[The court then recounts the specific allegations of the plaintiff’s complaint.]

These paragraphs allege breach of a specific promise “that defendant would prepare a trust document wherein Rogers and plaintiff would be co-trustees and through which plaintiff would receive the gift Rogers intended her to have,” a “trust document with plaintiff’s gift in it.” They allege, not that defendant performed this promise negligently, but that he did not perform it at all. As far as these allegations went, he might have broken the promise purposely, or under circumstances that might be a partial or entire defense to a negligence claim.

Lacking a detailed written contract, [resolution of the question] may depend on correspondence, memoranda, or testimony. When an alleged contract does not lend itself to incorporation of a writing in the complaint, the issue at least may have to await affidavits and possible counter-affidavits on motion for summary judgment. It should not have been decided on a motion to dismiss the complaint. For this reason, we reverse so much of the decision of the Court of Appeals as affirmed the dismissal of the contract claim.

Review Question 5. The court cites section 302 of the Restatement (Second) of Contracts, which separates non-party contract beneficiaries into two categories: *intended* and *incidental*. Intended beneficiaries, who can enforce the contract, must satisfy a two-pronged test. First, that “recognition of a right to performance in the

beneficiary is appropriate to effectuate the intention of the parties.” Consider our Luigi v. Peach scenario from the introduction to this unit. How do Peach and Luigi meet (or not meet) that standard?

Review Question 6. The second prong of Restatement section 302 can be satisfied in two different ways. One way is if “performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary.” Does Peach meet that standard in our hypothetical? What about Luigi? The second way is to show that “the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance.” Do either or both of our two characters meet this alternative standard?

Review Question 7. In *Barcelo v. Elliott*, 923 S.W.2d 575 (Tex. 1996), the Texas Supreme Court considered a case with facts substantially similar to *Hale v. Groce* and had this to say about the third-party beneficiary claim:

Plaintiffs also contend that, even if there is no tort duty extending to beneficiaries of an estate plan, they may recover under a third-party-beneficiary contract theory. While the majority of jurisdictions that have recognized a cause of action in favor of will or trust beneficiaries have done so under negligence principles, some have allowed recovery in contract. [citing, among other cases, *Hale v. Groce*]. In Texas, however, a legal malpractice action sounds in tort and is governed by negligence principles. *Cf. Heyer v. Flaig*, 70 Cal.2d 223, 74 Cal. Rptr. 225, 228, 449 P.2d 161, 164 (1969) (recognizing that third-party-beneficiary contract theory “is conceptually superfluous since the crux of the action must lie in tort in any case; there can be no recovery without negligence”). Even assuming that a client who retains a lawyer to draft an estate plan intends for the lawyer's work to benefit the will or trust beneficiaries, the ultimate question is whether, considering the competing policy implications, the lawyer's professional duty should extend to persons whom the lawyer never represented. [W]e conclude that the answer is no.

Barcelo, 923 S.W.2d at 579. Does the Texas approach or the Oregon approach make more sense to you? Are a lawyer's professional obligations so personal and special that they cannot be owed to someone other than the client—even if that is precisely what the client wants, or is the Texas court bending over backwards to protect lawyers from liability?

Review Question 8. Given the role that professional malpractice plays here, should tort analysis (which depends on enforcement of general norms) displace any third-party beneficiary analysis (which depends on the terms of individual contracts) when we look at questions like this? Or should they both be available?

Review Question 9. Lawyers do many things for clients that, if improperly carried out, might harm other persons—employees, investors, creditors, family members, and so on. As a future lawyer, what steps could you plausibly take to minimize exposure to these third party beneficiary actions?

INTERPOOL LTD. v. THROUGH TRANSPORT MUTUAL INSURANCE ASSOCIATION LTD.

United States District Court for the Southern District of Florida.
635 F. Supp. 1503 (S.D. Fla. 1985)

JAMES LAWRENCE KING, Chief Judge.

THIS CAUSE arises upon the Defendant's motion to stay the proceeding and compel arbitration.

Interpool Ltd and C.T.C. Corporation, the parties bringing this action, were the owners of certain containerized cargo equipment which was leased to Mayan Lines and Imparca, shipping companies. Both Mayan Lines and Imparca insured this equipment with Through Transport Mutual Insurance Ltd.

The insurance contract between Mayan/Imparca and Through Transport required arbitration of any disputes involving coverage. Interpool Ltd. was not a signatory to these contracts.

The equipment was damaged and Interpool filed suit in this court to recover the losses to its property, naming as defendants Mayan Lines as lessee, Imparca as lessee, and Through Transport as the insurer. Mayan Lines has filed bankruptcy and Imparca is a Venezuelan corporation that has apparently gone out of business and has not been served.

Through Transport has now filed a motion to stay the proceedings and compel arbitration as required by the terms of its agreement with Mayan/Imparca on the theory that Interpool Limited by claiming the position of a third party beneficiary, now stands in the shoes of Mayan/Imparca and is bound by their contractual agreement to arbitrate.

The crucial issue in this case is: may a party who is not a signatory to the contract but claims third party beneficiary status under the contract be bound by a clause in the contract requiring arbitration of the dispute.

Interpool and C.T.C. claim that because they never signed an agreement requiring arbitration that they are under no contractual duty to arbitrate, and thus have respectfully declined Through Transports offer to do so. Interpool and C.T.C. are

relying on an estoppel theory in that Through Transports confirmation of insurance coverage directed to Interpool made mention of coverage under Through Transports rule 31 and 12 but made no mention of any other rules applicable to Interpool or C.T.C. Thus Interpool/C.T.C. claim that they were without notice that they were to be bound by the arbitration clause contained in rule 35 of Through Transport's rules and bylaws.

Interpool and C.T.C. claim that the rules on their face only apply to Through Transport members and are thus not applicable to Interpool/C.T.C. who are not Interpool members. Interpool/C.T.C. are correct in their assertion that absent an agreement to arbitrate the parties cannot be required to submit to arbitration. *Seaboard Coast Line R.R. v. Trailer Train Co.* 690 F.2d 1343 (11th Cir. 1982).

The issue before this court is clearly one of law and not a factual dispute. Interpool/C.T.C. are assuming the benefits of the contract as third party beneficiaries. Interpool/C.T.C. now wish to "stand in the shoes" of the contracting parties Mayan/Imparca and derive the benefit of the Mayan/Imparca insurance contract with Through Transport. Through Transports contract with Mayan/Imparca is clear on its face that the parties will be bound by the rules and bylaws of the Through Transport association. Rule 35 of the association states that disputes will be put to arbitration for resolution.

The law is clear that a third party beneficiary is bound by the terms and conditions of the contract that it attempts to invoke. "The beneficiary cannot accept the benefits and avoid the burdens or limitations of a contract." *Trans-Bay Engineers & Builders, Inc. v. Hills*, 551 F.2d 370 (D.C.1976).

Ordinary principles of contract law are used to determine if a non-signatory is to be bound by the contract and "a party may be bound by an agreement to arbitrate even in the absence of a signature." *McAllister Bros. v. A & S Transport Co.* 621 F.2d 519 (2nd Cir. 1980). Interpool/C.T.C. are bound by the terms and conditions of the contract between Mayan/Imparca and Through Transport. The Rules applicable and incorporated into the contract, specifically Rule 35 require arbitration of disputes.

This court is empowered by 9 U.S.C. sec. 3 to stay this proceeding pending arbitration of this dispute. Therefore . . . [t]he Defendant's motion to stay this case is hereby GRANTED pending arbitration of this matter.

Review Question 10. Contract law, as we hope you have learned by now, is generally premised on the notion of voluntary consent by contracting parties. What justification is there, then, for the *Interpool* court's statement that "a party may be bound by an agreement to arbitrate even in the absence of a signature"? Doesn't that statement run contrary to the voluntary nature of contractual obligations?

Problems

Problem 27.1

Hank and Hilda have borrowed \$250,000 from Bank for the purpose (stated in the loan agreement) of building the couple's dream home. Hank and Hilda, in turn, contracted with Fly-by-Night Builders to build the house, authorizing the builders to draw down \$100,000 of the loan proceeds (which are on deposit at Bank) to get the project started. Builders then purchased \$30,000 worth of lumber on credit from Lumber Sellers, Inc. for the express purpose—stated in the credit agreement—of being used for construction of Hank and Hilda's house. Three months later, after it becomes apparent that Fly-by-Night Builders has mismanaged the project and squandered the first \$100,000 draw, it goes out of business, leaving no assets, but many debts, including unpaid \$30,000 debt owed to Lumber Sellers. Builders got the materials from Lumber Sellers, but used it for other projects and did not use any on Hank and Hilda's job.

Lumber Sellers has now sued Hank, Hilda, and Bank. The theory of the lawsuit is that Lumber Sellers is a third-party beneficiary of (1) the loan agreement between Hank, Hilda, and the Bank; (2) the construction contract between Hank, Hilda, and Builders, or (3) both. What result and why?

Problem 27.2

You have just passed the Bar Exam for the state of Catatonic and are in the process of joining a small firm that has hired you to develop a practice in the area of wills and estate planning. Unlike Oregon and Texas, Catatonic has never addressed the precise issue of whether the beneficiary of an estate plan can bring a third-party breach of contract claim against the attorney who drafted the will. The Catatonic Supreme Court has, in another factual setting, however, adopted section 302 of the Restatement (Second) of Contracts.

Draft a clause to include in your standard contract between "Lawyer" and "Client" that (hopefully) will prevent beneficiaries from being able to sue your firm for breach of contract. Remember that this clause is one that prospective clients will read and you might have to defend in person on the witness stand when you are sued by disappointed beneficiaries. In other words, seek to avoid potential liability but don't do so in a manner that would run off clients or offend a future jury. (If this seems like a grim request, keep in mind that a key task of transactional lawyers is to imagine worst case scenarios and come up with ways to prevent them from happening.)

Problem 27.3

Brandon Starr was signed by Tantamount Pictures to appear as the action hero lead in its upcoming high-budget film, *Raiders of the Lost Jurassic Park*. The contract between Starr and Tantamount requires Starr to procure and maintain a \$2 million life and disability insurance policy payable to Tantamount in the event that Starr is unable to fulfil his obligations to appear in the movie. Starr did indeed take out the required policy with Casualty Insurance Company and made the premium payments for the first four months, but he then missed the following two months. Casualty Insurance sent numerous notices to Starr informing him that if he failed to make a premium payment for a total of 90 days, the policy would, per its express terms, be cancelled and not subject to reinstatement. On the 93rd day since Starr's first missed payment, he was tragically killed when his automobile careened off the side of a coastal cliff.

(a) Tantamount Pictures promptly sent a notice of claim to Casualty Insurance, which denied coverage based on the lapse of the policy. Tantamount argued that its rights were established by its contract with Starr and were unaffected by Starr's separate failure to make premium payments. What result and why?

(b) Same facts as part (a), except the insurance policy in question is subject to a state insurance statute that requires insurers to reinstate policies up to 120 days since the original missed payment, provided that the policyholder makes the premium payments current. What result if Tantamount Pictures tenders payment within the 120 day period?

Be sure that you consider Restatement (Second) of Contracts section 309 in connection with this problem.

Problem 27.4

Think back to the *In re Baby M* case at the beginning of the course (Units 1 and 2). In the Unit 2 materials, the New Jersey Supreme Court ultimately held that the surrogacy agreement between Mary Beth Whitehead (the surrogate mother) and William Stern was unenforceable on public policy grounds. Imagine instead that the contract actually was enforceable, just like the trial court decided at the beginning of Unit 2. In that situation, would William Stern's wife, Elizabeth Stern—who was not a party to the surrogacy contract—qualify as a third-party beneficiary? Why or why not?

Unit 28: Assignment and Delegation

CONTRACT NONPARTIES

Part Two

FOCUS OF THIS UNIT

The nonparties we considered in the previous unit—third-party beneficiaries—can gain rights under contract law based largely on the original intent of the parties to the contract. They are parties *in their own right* from the day the contract is formed. This unit deals with a very different situation: where nonparties take over the rights and duties of contracting parties *after* the inception of the contract. An example may help explain what we mean here.

A Simple Contract. Suppose that builder Burge has contracted with Snyder to build a department store, Snyder’s Shop-a-Rama, in exchange for \$1 million. Under this contract, Snyder has the *right* to performance from Burge—construction of the store. Likewise, Burge has the *right* to Snyder’s performance—payment of the \$1 million. Each party’s contract rights to the other’s performance under these facts also create corresponding duties.⁴ Thus, we can equally say that Burge has a legal *duty* to build the department store for Snyder, while Snyder has a legal *duty* to pay Burge \$1 million. In a bilateral contract like this example, both sides have rights the performance of another (which are legal benefits) and duties to perform (which are legal detriments).

Passing Along Rights and Duties. With these rights and duties in mind, consider the possibility that the parties may want to move them around. In your Property course, you have likely heard of the “bundle of sticks” approach to property rights, in which various sticks from the bundle can be removed and transferred. Contract rights are a form of property. What if Snyder decides that he, in fact, does not want to own or run a department store, but he has heard that Williston would be

⁴ [One or more of your first-year professors may have introduced you to the idea that all legal duties have reciprocal rights, and vice versa. Thus, my right to build a fence on my property implies your duty not to tear down that fence; your duty to pay me money implies my right to get it, and so on. These were dubbed “jural correlatives” by Professor Hohfeld and have had a great deal of influence, particularly in property and tort law. See, e.g., Wesley Newcomb Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 26 YALE L.J. 710 (1917).—Eds.]

interested in jumping into such a business venture? Can Snyder and Willison agree to substitute Williston into Snyder's place in the original contract? Or suppose Burge has decided to exit the construction business, so he arranges for Corbin to build Snyder's department store for him. Neither Snyder or Burge may have a particular objection—Williston may have better credit and Corbin may be a better construction company—but what if one of the original parties objects? Does that party still have the right to transfer its rights and duties?

Getting the Vocabulary Right. The law of *assignment and delegation* is where we find the answers to these questions, but exploring that law requires understanding some terminology. Contract rights (the benefits) are *assigned*, while contract duties (the obligations) are *delegated*. Attorneys sometimes lump assignment and delegation together and refer to both concepts as assignment, but doing so is incorrect. Indeed, this kind of imprecision that can get a transactional lawyer in trouble. Suppose the Snyder-Burge contract says that “Burge may the *assign* the contract to another builder”—that provision arguably means that Burge can transfer his *benefit* (“assign”), but cannot transfer his *obligation* (“delegate”). Snyder may be indifferent about who gets the money he pays Burge, but may have a strong objection to having someone else do the work, especially if he selected Burge because of the latter's special skill and expertise.

The original contracting party who makes an assignment is known as an *assignor*, while the nonparty who receives the assignor's rights is called the *assignee*. Where duties are delegated, the original contracting party is called the *delegator* while the nonparty who takes on the delegator's duties under the contract is called the *delegatee*.⁵

The Basic Rules. The general rules are pretty simple. (1) Contractual benefits may be assigned, and contract obligations may be delegated, *except* sometimes when they cannot. (2) Both assignment and delegation may be limited or prohibited by the parties' agreement, *except* when such limits or prohibitions are not effective. Fleshing out the exceptions to these general rules is the main challenge. The basic rules on assignments are found in section 317 of the Restatement (Second) of Contracts, while those on delegation are in section 318. Article 2 of the UCC has its own rules for sale-of-goods contracts in section 2-210. Some of the UCC's approach to interpretation of assignment and delegation provisions is also reflected in section 322 of the Restatement. You should look at those sections as you read the cases in this unit. Interestingly, the CISG has no rules of its own on the topic, which means if you are working in international sales transactions you may find yourself using the domestic

⁵ [We're not terribly fond of all these “-or” and “-ee” terms, as they can be a recipe for confusion and errors in contract drafting. (Practice tip: When drafting contracts, use the parties' names, or some functional terms like “buyer” and “seller” instead whenever possible.) Nonetheless, you need to recognize these sort of terms as they frequently appear in both transactional documents and court opinions. –Eds.]

law of individual countries, which can raise challenges if they conflict with one another.

Cases and Materials

BURNISON v. JOHNSTON
Supreme Court of Nebraska
277 Neb. 622, 764 N.W.2d 96 (Neb. 2009)

CONNOLLY, J.

We are asked to decide whether a law firm can assign its right to collect unpaid legal fees. The law firm assigned its claim to the appellant, Mary Burnison. Burnison filed an action seeking recovery of the fees from the appellee, Kathleen Johnston, and in response, Johnston raised several defenses. After trial, the district court dismissed Burnison’s claims because it concluded that she lacked standing to bring the action. The court reasoned that the law firm had impermissibly assigned personal legal services. We conclude that public policy does not bar assignment of a right to collect unpaid legal fees.

Since 1994, the law firm Martin & Martin, P.C., had provided legal services to Johnston and her husband regarding their real estate holdings. In October 2001, the firm assigned to Burnison “all right, title, and interest in any cause of action arising from legal services that MARTIN & MARTIN, P.C. rendered to . . . Johnston[,] at her request from May 1, 1996 through February 25, 1998.”⁶

Burnison filed a complaint against Johnston, seeking recovery of unpaid legal fees for services provided by the assignor. She alleged breach of oral contract and quantum meruit theories of recovery. Burnison alleged that (1) the firm had performed legal services for Johnston in 1996 and 1997; (2) she only sporadically paid for some of these services; and (3) despite demand for payment, she owed \$76,323 in legal fees and \$32,918 in interest.

In her answer, Johnston denied that Burnison was the real party in interest or that any contract existed between her and the firm. Her answer included a litany of affirmative defenses. She alleged that (1) the firm’s services were provided for

⁶ [You might wonder why the law firm would assign the right to Burnison. Although the court does not actually state the reason, the likelihood is that this was a delinquent account that the firm sold (at a discounted price) to a debt collector. The entire debt collection industry relies on the fact that creditors can assign their rights to collect money for goods or services already received.—Eds.]

another party; (2) the claims for payment resulted from fraud; and (3) the statute of limitations barred the claims. She admitted that the firm had performed work for her. But she alleged that (1) its legal work violated the law and ethical standards for attorneys; (2) its performance was contrary to the standard of professional care for attorneys in Nebraska; and (3) the firm “fraudulently performed” because the attorneys had advised her to take actions that were illegal and which subjected her to legal liability and loss of property. She also alleged that the firm had fraudulently listed charges and payment on her account to defeat the statute of limitations.

At trial, the parties stipulated that the firm’s hourly rate was fair. But Johnston disputed whether the firm provided services for her and whether the services were of any value to her. In addition, she contended that some of the assignor’s actions were unethical, which she alleged precluded the assignee’s recovery of unpaid legal fees.

In its order, the court concluded that Burnison lacked standing as an assignee to seek recovery of the unpaid legal fees. It ruled that the assignment upon which she relied was an improper attempt to assign personal legal services. It reasoned that the language in the firm’s assignment to Burnison was too broad because it assigned a cause of action instead of an unpaid fee.

Burnison contends that Nebraska law permits an assignment of a claim for unpaid legal fees and that our cases on the nonassignability of malpractice claims are not controlling. She argues that none of the public policy considerations that prohibit the assignment of legal malpractice claims are present when an attorney assigns a claim to collect unpaid legal fees for services already provided. She distinguishes a legal malpractice claim as a tort action resting on the attorney’s personal fiduciary duty to provide professional services to a client. She argues that in contrast to a malpractice claim, a claim to collect unpaid legal fees is a contract action that does not involve a duty to provide personal services. In brief, she argues that “the duty to professionally provide legal services is personal; the duty to pay for that service which has already been performed is not.”

At the outset, we note that a likely stumbling block here was the failure of our case law to consistently use the proper terminology to discuss the transfer of contractual rights and duties. Unless a party transfers both its rights and its duties under a contract, it is important to distinguish between the assignment of contractual rights and the delegation of performance of a duty. *See* Restatement (Second) of Contracts §§ 317 & 318 (1981);⁷ 3 E. ALLAN FARNSWORTH, FARNSWORTH ON

⁷ [Section 317 Assignment of a Right

(1) An assignment of a right is a manifestation of the assignor's intention to transfer it by virtue of which the assignor's right to performance by the obligor is extinguished in whole or in part and the assignee acquires a right to such performance.

(2) A contractual right can be assigned unless

CONTRACTS § 11.1 (3d ed. 2004). Although the court stated that the firm had impermissibly attempted to assign personal legal services, it apparently meant that the firm had impermissibly attempted to delegate performance of its duty to provide legal services.

But this case does not involve delegation of performance of a duty under a contract for personal services. And Johnston admits that the firm did not delegate any obligation to perform legal services for her. We conclude that the district court erred in finding that the firm had attempted to delegate performance of its duty to provide legal services. Here, the firm assigned only its contractual right to receive Johnston's payment for services rendered. But Johnston argues that public policy prohibited the firm's assignment and that we should therefore affirm the court's judgment even if its reasoning was incorrect.

We have held that a contractual right to the benefit of a promise cannot be assigned if the obligor reasonably intended for the right to be exercised only by the party with whom it contracted. The rule usually applies when a promise involves a relationship of personal trust or confidence or the obligor has expectations of counterperformance. *See Schupack v. McDonald's System, Inc.*, 264 N.W.2d 827 (Neb. 1978). *See also* 29 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 74:10 (Richard A. Lord ed., 4th ed. 2003). Otherwise, contractual rights are generally assignable unless the terms validly preclude assignment or the assignment is contrary to statute or public policy. *Accord* Rest. 2d § 317; WILLISTON, *supra*.

In *Peterson v. Hynes*, 371 N.W.2d 664 (Neb. 1985), we affirmed a party's right to assign a claim for unpaid fees under a contract to provide personal services. There, the buyers of stock in a bank holding company promised in an addendum to the purchase agreement that they would hire the sellers as consultants and pay them

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- (a) the substitution of a right of the assignee for the right of the assignor would materially change the duty of the obligor, or materially increase the burden or risk imposed on him by his contract, or materially impair his chance of obtaining return performance, or materially reduce its value to him, or
 - (b) the assignment is forbidden by statute or is otherwise inoperative on grounds of public policy, or
 - (c) assignment is validly precluded by contract.

Section 318 Delegation of Performance of Duty

(1) An obligor can properly delegate the performance of his duty to another unless the delegation is contrary to public policy or the terms of his promise.

(2) Unless otherwise agreed, a promise requires performance by a particular person only to the extent that the obligee has a substantial interest in having that person perform or control the acts promised.

(3) Unless the obligee agrees otherwise, neither delegation of performance nor a contract to assume the duty made with the obligor by the person delegated discharges any duty or liability of the delegating obligor. —Eds.]

specified fees for a defined period. But the buyers never allowed the sellers to provide consulting services and paid them only a fraction of the promised fees. The sellers assigned their claim to recover the unpaid fees under the agreement. On appeal, the buyers argued that they were not liable because the sellers could not assign their contractual rights. We noted that the sellers had not delegated their obligation to perform consulting services. We held that a right to receive money under a contract may be assigned

unless there is something in the terms of the contract manifesting the intention of the parties that it shall not be assigned. This is true of money due or to become due under a contract involving personal skill, service, or confidence; the party who has performed such obligations, or who has contracted to do so, may assign his right to the money earned or which he is to earn, although the contract itself is not assignable. 10

Id. at 577, 371 N.W.2d at 667 (*quoting* 6 AM. JUR. 2D *Assignments* § 16 (1963)). *See also* Rest. 2d § 317, cmt d. Johnston acknowledges our holding in *Peterson*. But she contends that the firm's assignment was against public policy. She argues that Burnison must prove the value of the firm's services and its compliance with professional responsibility requirements. Because she has malpractice defenses to the firm's claim for unpaid fees, she argues that the same public policy concerns that prohibit the assignment of attorney malpractice claims apply here. We disagree.

Johnston cites no case holding that such an assignment violates public policy. It is true that an assignee's rights are no greater than the assignor's and that Burnison must prove the value of its services and compliance with professional standards. And it is not uncommon for clients to allege counterclaims of legal malpractice in response to actions to recover unpaid legal fees. But Johnston's reliance on the public policy reasons for prohibiting the assignment of tort claims for legal malpractice is misplaced. Assignments of malpractice claims are prohibited to avoid undermining the duty of confidentiality and other professional duties that arise from the client-attorney relationship. Those public policy concerns are not present here.

We conclude that public policy does not prohibit an attorney's assignment of a claim for unpaid legal fees simply because a client might raise malpractice defenses. Johnston's defenses against the assigned claim are not defenses against the assignment itself and did not prevent Burnison from attempting to enforce her interest.

Accordingly, we reverse the judgment of the district court and remand the cause with directions to the district court to make the necessary findings of fact and conclusions of law and decide the remaining issues.

Review Question 1. The *Burnison* court says that “Assignments of malpractice claims are prohibited to avoid undermining the duty of confidentiality and other professional duties that arise from the client-attorney relationship. Those public policy concerns are not present here.” Why is Johnson not allowed to assign (*i.e.*, sell) her (tort) malpractice claim against the Martin & Martin law firm, but the firm *is* allowed to assign and sell its (contract) claim against Johnson for unpaid legal fees? Are the public policy concerns really that different, or is this simply a situation where the law protects lawyers more than their clients?

MINGLEDORFF’S INC. v. HICKS

Court of Appeals of Georgia
133 Ga. App. 27, 209 S.E.2d 661 (1974)

BELL, Chief Judge.

Air Conditioning and Heating Service Co., Inc., entered into a written contract with Hicks for the installation of heating and air conditioning systems in an apartment complex. The contract contained a clause prohibiting the assignment of the contract, “or any part thereof” without the written consent of the other party. Air Conditioning assigned to the plaintiff Mingledorff’s a portion of the money due Air Conditioning on the contract without the written consent of defendants. The trial court granted defendants’ motion for judgment on the pleadings.

Plaintiff contends that the anti-assignment clause in issue is invalid. [Georgia] Code Ann. § 85-1803 permits the assignment of choses in action⁸ arising on a contract but it does not prohibit parties from providing that their contract shall not be assignable. In *Bewick Lumber Co. v. Hall*, 21 S.E. 154 (Ga. 1894), it was held that a credit check payable on demand was assignable in spite of language on the check that it was not transferable, citing an earlier version of § 85-1803. However, in *Cowart v. Singletary*, 79 S.E. 196 (Ga. 1913) it was noted that the instrument in *Bewick* was not an executory contract containing mutual obligations and stated that subject to certain modifications “the parties to an executory contract may in terms prohibit its assignment, so that an assignee does not succeed to any rights in the contract by virtue of the assignment.” The contract here is clearly an executory one with mutual obligations between the parties. While, as contended by plaintiff, it may have been completely executed by plaintiff’s assignor, this fact would not require a result invalidating the anti-assignment clause. The nonassignment clause is valid and enforceable. The provisions found in the Uniform Commercial Code, UCC §§ 2-210(2)

⁸ [Do you know what a “chose in action” is? If not, now would be a good time to look it up.—Eds.]

and 9-318(4), which nullify the effects of anti-assignment provisions, have no application to this contract as it is not one for the sale of goods but is a contract for services and labor with an incidental furnishing of equipment and materials.

The contract provision is plain and unambiguous and is not subject to interpretation or construction. It provided that the “subcontractor (plaintiff’s assignor) shall not sublet, assign or transfer this sub-contract, or any part thereof without the written consent of the defendant.” The phrase “or any part thereof” will operate to preclude the limited assignment of a right under the contract, to wit: Money due the plaintiff’s assignor.

Judgment affirmed.

Review Question 2. The contract in *Mingledorff’s* was a mixed sale of goods and services that could plausibly have qualified as a Uniform Commercial Code sale of goods. Suppose that, contrary to the outcome in the actual case, the contract in *Mingledorff’s* had been held to be a sale of goods governed by UCC § 2-210(2). Would the outcome of the case have been different? Read the statute and explain why or why not. Can you imagine any problems arising from “choses in action” being subject to assignment by contracting parties?

GILMORE v. SCI TEXAS FUNERAL SERVICES, INC.

Court of Appeals of Texas
234 S.W.3d 251 (Tex. App.—Waco 2007).

FELIPE REYNA, Justice.

Pam Pickens, who was forty years’ old, suffered a series of unexplained seizures which caused her brain function to cease. She was removed from artificial life support only days after she was admitted to the intensive care unit. Her mother Jane Gilmore handled the funeral arrangements.

Gilmore made the arrangements with Connally/Compton Funeral Home. The Connally/Compton representative recommended the “Wilbert Way” to Gilmore, which involves a ceremonial lowering of the casket into a vault and the sealing of the vault at the conclusion of the graveside service. The Wilbert Way is a service provided by the Wilbert Vault Company.

At the graveside service, the pastor stepped aside after he finished a Scripture reading, and two men approached the casket. One of them, Wilbert Vault employee James Turner, attached a pair of vice grips to a lowering device and began lowering

the casket into the vault. Several witnesses testified that the lowering device emitted a ratcheting sound which was described by Gilmore's husband as being similar to a winch pulling a boat onto a trailer. As the casket was being lowered, there was a "big boom," and the casket turned sideways and fell an unspecified distance to the bottom of the vault. The casket was partially opened by the impact, Pam's arm was exposed, and several mementos spilled out.

According to the testimony, the peaceful setting suddenly broke into pandemonium. Those in attendance scattered. There were screams. The pastor noticed "a young girl laying out on the ground." According to the Connally/Compton funeral director, "everyone was visibly upset." Several men righted the casket. The pastor had others stand in a line between the vault and the seats to provide a shield for those in attendance. At the funeral director's suggestion, the casket was opened, Pam's body was repositioned, and the mementos were returned to the casket.

Wilbert Vault had the lowering device taken to its offices in Grapevine "to determine what had gone wrong with it." It was "determined that the device couldn't be repaired," so Wilbert Vault discarded it with other scrap metal.

Gilmore and the Pickenses filed suit against Connally/Compton and Wilbert Vault alleging [multiple claims, including negligence and] breach of contract.

At trial, the jury was charged on the breach of contract and negligence claims as well as the joint-enterprise theory. The jury refused to find that Connally/Compton breached its contract, that Connally/Compton and Wilbert Vault were engaged in a joint enterprise, or that any negligence on Connally/Compton's part was a proximate cause of the occurrence in question. The jury found that Wilbert Vault's negligence was a proximate cause but also found that none of the plaintiffs suffered compensable mental anguish.

Appellants [contend] that the court abused its discretion by denying their motion for new trial in which they argued that the jury's refusal to find that Connally/Compton breached its contract is against the great weight and preponderance of the evidence. Appellants argue in this regard that the primary breach of contract is Connally/Compton's failure to provide the Wilbert Way as contemplated by the parties' contract.

Under the plain language of the written contract, Gilmore purchased a Wilbert Venetian Vault and the "Dignity Heritage Memorial Package" from Connally/Compton for Pam's burial. Although there is no express provision in the contract regarding the purchase of the Wilbert Way, no one disputes that the purchase of this particular vault and the Dignity Heritage Memorial Package includes purchase of the Wilbert Way service. *See Transcontinental Gas Pipeline Corp. v. Texaco, Inc.*, 35 S.W.3d 658, 670 (Tex. App.—Houston [1st Dist.] 2000, pet. denied) (trade usage is admissible to explain contract terms so long as it does not

contradict express terms of contract); *see also* Tex. Bus. & Com. Code Ann. § 1.303(c) (Vernon Supp. 2006), § 2.202(1) (Vernon 1994).

A breach of contract has been defined as “a failure, without legal excuse, to perform any promise that forms the whole or part of a contract.” 23 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 63:1 (4th ed.2002) (emphasis added); accord *Crim Truck & Tractor Co. v. Navistar Int’l Transp. Corp.*, 823 S.W.2d 591, 597 (Tex.1992) (“the failure to perform the terms of a contract is a breach of contract”).

Connally/Compton argues that the failure of the lowering device does not constitute a breach of the parties’ contract on its part because Wilbert Vault and not Connally/Compton was responsible for the lowering device. We disagree. Section 318(3) of the Restatement (Second) of Contracts provides:

Unless the obligee agrees otherwise, neither delegation of performance nor a contract to assume the duty made with the obligor by the person delegated discharges any duty or liability of the delegating obligor.

Restatement (Second) of Contracts § 318(3) (1981).

Connally/Compton also suggests that Appellants suffered no contract damages from this breach because Connally/Compton wrote off the \$8,878 which Gilmore still owed. We likewise reject this assertion. Even assuming a jury determined that Gilmore suffered no actual pecuniary loss, she would at minimum be entitled to nominal damages.

It is undisputed that Pam’s graveside service did not conclude with a ceremonial lowering via the Wilbert Way as contemplated by the contract. There is no evidence in the record that Gilmore agreed to discharge Connally/Compton from this obligation, notwithstanding Connally/Compton’s delegation of this duty to Wilbert Vault. *See Honeycutt*, 992 S.W.2d at 579; Restatement (Second) of Contracts § 318(3). Therefore, the jury’s refusal to find a breach of contract “is so against the great weight and preponderance of the evidence that it is clearly wrong and unjust.” *Dow Chem. Co.*, 46 S.W.3d at 242.

For the foregoing reasons, we sustain Appellants’ first issue [and reverse] in part[.]

Review Question 3. The *Gilmore* opinion expressly raises the possibility that Connally/Compton Funeral Home could have obtained consent from Gilmore discharging the funeral home’s responsibility as to the duties that were delegated to Wilbert Vault. Assuming that such consent language would become part of the so-

called “fine print” of a standard form contract, should such standardized consent be what determines the outcome?

ROSENBERG v. SON, INC.
Supreme Court of North Dakota.
491 N.W.2d 71 (N.D. 1992)

ERICKSTAD, Chief Justice.

Harold Rosenberg and Gladys E. Rosenberg (Rosenbergs) appeal two district court decisions granting summary judgment in favor of Son, Inc., and Mary Pratt. We reverse and remand for further proceedings.

On February 8, 1980, Pratt entered into a contract for the sale of a business with the Rosenbergs, agreeing to purchase the Rosenbergs’ Dairy Queen located in the City Center Mall in Grand Forks. The terms of the sales contract for the franchise, inventory, and equipment were a purchase price totaling \$62,000, a \$10,000 down payment, and \$52,000 due in quarterly payments at 10 percent interest over a 15-year-period. The sales contract also contained a provision denying the buyer a right to prepayment for the first five years of the contract.

Mary Pratt assigned her rights and delegated her duties under the sales contract to Son, Inc., on October 1, 1982.⁹ The assignment agreement contained a “Consent To Assignment” clause which was signed by the Rosenbergs on October 14,

⁹ [By the court] The term “assign” is normally associated with a party’s rights under a contract (i.e., getting paid, receiving goods); whereas the term “delegate” is associated with a party’s duties under a contract (i.e., making a payment, performing a service). However, it is a common practice to call the assigning of rights and delegating of duties merely an “assignment of contract.” This is especially true when language such as “all right, title and interest” is used. This was the exact language contained in the assignment agreement between Pratt and Son, Inc., and also in the assignment agreement between Son, Inc., and Merit Corporation (to be discussed later).

An assignment of ‘the contract’ or of ‘all my rights under the contract’ or an assignment in similar general terms is an assignment of rights and unless the language or the circumstances (as in an assignment for security) indicate the contrary, it is a delegation of performance of the duties of the assignor and its acceptance by the assignee constitutes a promise by him to perform those duties. This promise is enforceable by either the assignor or the other party to the original contract.

Section 41-02-17(4), N.D.C.C. See also 67 AM. JUR. 2D Sales § 383, at 650. Thus, the assignment agreements in this case not only assigned rights, they also delegated duties to the assignees.

1982.¹⁰ The assignment agreement also included a “save harmless” clause in which Son, Inc., promised to indemnify Pratt.¹¹ Subsequent to this transaction, Mary Pratt moved to Arizona and had no further knowledge of, or involvement with, the Dairy Queen business. Also following the assignment, the Dairy Queen was moved from the City Center Mall to the corner of DeMers and North Fifth Street in Grand Forks.

The sales contract was then assigned by Son, Inc., to Merit Corporation (Merit) on June 1, 1984. This assignment agreement did not contain a consent clause for the Rosenbergs to sign. However, the Rosenbergs had knowledge of the assignment and apparently acquiesced. They accepted a large prepayment from Merit, reducing the principal balance due to \$25,000. Following this assignment, Merit pledged the inventory and equipment of the Dairy Queen as collateral for a loan from Valley Bank and Trust of Grand Forks.

Payments from Merit to the Rosenbergs continued until June of 1988, at which time the payments ceased, leaving an unpaid principal balance of \$17,326.24 plus interest. The Rosenbergs attempted collection of the balance from Merit, but the collection efforts were precluded when Merit filed bankruptcy. The business assets pledged as collateral for the loan from Valley Bank and Trust of Grand Forks were repossessed. The Rosenbergs brought this action for collection of the outstanding debt against Son, Inc., and Mary Pratt.

It is a well-established principle in the law of contracts that a contracting party cannot escape its liability on the contract by merely assigning its duties and rights under the contract to a third party. This principle is codified in [UCC § 2-210(1)]:

Delegation of performance; Assignment of rights.

- (1) A party may perform his duty through a delegate unless otherwise agreed or unless the other party has a substantial interest in having his original promisor perform or control the acts required by the contract. *No delegation of performance relieves the party delegating of any duty to perform or any liability for breach.*

¹⁰ [By the court] The language of the consent clause was very brief and direct. In full, it read: “The undersigned, Harold Rosenberg and Gladys E. Rosenberg, sellers in the above described Contract of Sale, do hereby consent to the above assignment.”

¹¹ [By the court] The indemnification clause reads as follows:

And the said party of the second part [Son, Inc.] covenants and agrees to and with the said party of the first part [Pratt] that the said party of the second part will pay the said purchase price and will observe and perform all the terms, conditions and stipulations in the said agreement mentioned which are thereunder by the said party of the first part to be observed and performed, and will save harmless and keep indemnified the said party of the first part against all claims, demands and actions by reason of the failure of the said party of the second part to observe and perform the said agreement.

(emphasis added).

Professor Corbin explained this point succinctly in his treatise on contract law.

An assignment is an expression of intention by the assignor that his duty shall immediately pass to the assignee. Many a debtor wishes that by such an expression he could get rid of his debts. Any debtor can express such an intention, but it is not operative to produce such a hoped-for result. It does not cause society to relax its compulsion against him and direct it toward the assignee as his substitute. In spite of such an ‘assignment,’ the debtor’s duty remains absolutely unchanged. The performance required by a duty can often be delegated; but by such a delegation the duty itself is not escaped.

4 CORBIN ON CONTRACTS § 866 at 452.

This rule of law applies to all categories of contracts, including contracts for the sale or lease of real property, service contracts, and contracts for the sale of goods, which is present in the facts of this case.

In the case of a contract for the sale of goods, the assignment and delegation may be by the buyer as well as by the seller. The buyer’s assignment of his right to the goods and his delegation of the duty to pay the price are both effective; but he himself remains bound to pay the price just as before. If the assignee contracts with the assignor to pay the price, the seller can maintain suit for the price against the assignee also, as a creditor beneficiary of the assumption contract; the seller has merely obtained a new and additional security.

Id. at 454-455 (emphasis added) (footnotes omitted).

Thus, when Pratt entered into the “assignment agreement” with Son, Inc., a simple assignment alone was insufficient to release her from any further liability on the contract. *See Jedco Development Co., Inc. v. Bertsch*, 441 N.W.2d 664 (N.D.1989) (lessee is not relieved of this obligation to pay rent merely because he had assigned lease with lessor’s consent absent a novation); *Brooks v. Hayes*, 133 Wis. 2d 228, 395 N.W.2d 167 (1986) (party delegating duties under contract is not relieved of responsibility for fulfilling an obligation or liability in the event of a breach). *See also* Restatement (Second) of Contracts § 318; 6A C.J.S. Assignments § 97 at 753; 6 AM. JUR. 2D Assignments § 110; 67 AM. JUR. 2D Sales § 383, at 649.

It is not, however, a legal impossibility for a contracting party to rid itself of an obligation under a contract. It may seek the approval of the other original party for release, and substitute a new party in its place. In such an instance, the transaction is no longer called an assignment; instead, it is called a novation. If a novation occurs in this manner, it must be clear from the terms of the agreement that a novation is

intended by all parties involved. “An obligor is discharged by the substitution of a new obligor only if the contract so provides or if the obligee makes a binding manifestation of assent, forming a novation.” Restatement (Second) of Contracts § 318 cmt. d. Therefore, both original parties to the contract must intend and mutually assent to the discharge of the obligor from any further liability on the original contract.

It is evident from the express language of the assignment agreement between Pratt and Son, Inc., that only an assignment was intended, not a novation. The agreement made no mention of discharging Pratt from any further liability on the contract. To the contrary, the latter part of the agreement contained an indemnity clause holding Pratt harmless in the event of a breach by Son, Inc. Thus, it is apparent that Pratt contemplated being held ultimately responsible for performance of the obligation.

Furthermore, the agreement was between Pratt and Son, Inc.; they were the parties signing the agreement, not the Rosenbergs. An agreement between Pratt and Son, Inc., cannot unilaterally affect the Rosenbergs’ rights under the contract.

As mentioned earlier, the Rosenbergs did sign a consent to the assignment at the bottom of the agreement. However, by merely consenting to the assignment, the Rosenbergs did not consent to a discharge of the principal obligor—Pratt. Nothing in the language of the consent clause supports such an allegation. A creditor is free to consent to an assignment without releasing the original obligor.

Where the obligee consents to the delegation, the consent itself does not release the obligor from liability for breach of contract. More than the obligee’s consent to a delegation of performance is needed to release the obligor from liability for breach of contract. For the obligor to be released from liability, the obligee must agree to the release. If there is an agreement between the obligor, obligee and a third party by which the third party agrees to be substituted for the obligor and the obligee assents thereto, the obligor is released from liability and the third person takes the place of the obligor. Such an agreement is known as a novation.

Brooks v. Hayes, 395 N.W.2d at 174. See also *Jedco Development Co., Inc. v. Bertsch*, 441 N.W.2d at 666 (“a lessee is not relieved of his obligation to pay rent merely because he has assigned the lease with the lessor’s consent ... rather, the lessor must intend to release the lessee”). Thus, the express language of the agreement and intent of the parties at the time the assignment was made did not contemplate a novation by releasing Pratt and substituting Son, Inc., in her stead.

As stressed above, a party assigning its rights and delegating its duties is still a party to the original contract. An assignment will not extinguish the relationship and obligations between the two original contracting parties. However, an

assignment does result in the assignor having a surety relationship, albeit involuntary, with the assignee, but not with the other original contracting party.

A common instance of involuntary suretyship, at least as between the principal and surety themselves, occurs where one party to a contract [Son, Inc.], as a part of the agreement, assumes an indebtedness owing by the other [Pratt] to a third person [the Rosenbergs], the one assuming the indebtedness becoming the principal [Son, Inc.], and the former debtor a surety [Pratt].

72 C.J.S. Principal and Surety § 35 (emphasis added). Therefore, in the present facts, Pratt enjoyed a surety position as to Son, Inc., but remained a principal on the contract with the Rosenbergs.

The inquiry as to Pratt's liability does not end at this juncture. Pursuant to guaranty law, the trial court released Pratt from any liability on the contract due to the changes or alterations which took place following her assignment to Son, Inc. While it is true that Pratt cannot be forced to answer on the contract irrespective of events occurring subsequent to her assignment, it is also true that she cannot be exonerated for every type of alteration or change that may develop.

The buyer can assign his right to the goods or land and can delegate performance of his duty to pay the price. He himself remains bound as before by his duty to pay that price. But observe that he remains bound 'as before'; the assignee and the seller cannot, by agreement or by waiver, make it the assignor's duty to pay a different price or on different conditions. If the seller is willing to make such a change, he must trust to the assignee alone. It has been held that, if a tender of delivery by a certain time is a condition precedent to the buyer's duty to pay, the assignee of the buyer has no power to waive this condition, and substantial delay by the seller will prevent his getting judgment against the assignor for the price. If the assignee has contracted to pay the price, his waiver of the condition will be effective in a suit against him, but it will not be allowed to prejudice the position of the assignor, who now occupies substantially the position of surety.

4 CORBIN ON CONTRACTS § 866, at 458-459 (emphasis added) (footnotes omitted).

The trial court decided pursuant to guaranty statutes, Section 22-01-15, N.D.C.C., and case law, *Tri-Continental Leasing Corp. v. Gunter*, 472 N.W.2d 437, that any alteration in the underlying obligation resulted in a release of Pratt on the contract. It appears that an assignor occupies a much different position from that of a guarantor; not every type of alteration is sufficient to warrant discharge of the assignor. As suggested by Professor Corbin in the language highlighted above, the

alteration must “prejudice the position of the assignor.” 4 CORBIN ON CONTRACTS § 866, at 459.

Accordingly, unless the other contracting party has consented to release him, the assignor remains bound by his obligations under the contract and is liable to the other party if the assignee defaults,.... However, the assignor is responsible only for the obligation which he originally contracted to assume, and the assignee cannot, without the assignor’s knowledge, increase the burden.

6A C.J.S. Assignments § 97 at 753-754 (emphasis added) (footnotes omitted).

If the changes in the obligation prejudicially affect the assignor, a new agreement has been formed between the assignee and the other original contracting party. More concisely, a novation has occurred and the assignor’s original obligation has been discharged. In reversing and remanding in *Jedco*, we said:

We cannot determine as a matter of law that the assignment was intended to be a novation which resulted in a release of [the assignor’s] liability under the lease. Because there are different inferences to be drawn from the undisputed facts, reasonable persons could draw more than one conclusion in this case. Therefore, the summary judgment is reversed and the case is remanded for further proceedings.

441 N.W.2d at 668. We must do the same in this case. Thus, we reverse the summary judgment and remand for further proceedings.

Review Question 4. “An assignment will not extinguish the relationship and obligations between the two original contracting parties.” says the *Rosenberg* court. “However, an assignment does result in the assignor having a surety relationship, albeit involuntary, with the assignee, but not with the other original contracting party.” What exactly is a surety relationship? What is the difference between the legal relationship the Rosenbergs have with Mary Pratt and the legal relationship the Rosenbergs have with Son, Inc.?

Review Question 5. Assume that you are Mary Pratt’s transactional lawyer during all of the assignments and delegations that occurred in *Rosenberg v. Son, Inc.* What would you advise your client to do differently as compared to what she did (or did not) do in the actual case?

Problems

Problem 28.1

Carla Customer wanted some landscape work done at her home. She got a bid for \$15,000 from Ace Garden Service, a well-established and very highly rated firm with a stellar reputation. She also received a bid of \$10,000, from Deuce Contractors, a smaller entity with a number of bad online reviews. She signed a contract with Ace, primarily because of its exceptional reputation. She was thus surprised when the crew that showed up to do the work came from Deuce Contractors, who told her they had been delegated the work by Ace. Carla objected, but Ace told her that there was no restriction on its delegation of duties under the contract. Carla wants to back out of the contract with Ace. Does she have to accept the work from Deuce? If Carla finds the work to be of insufficient quality, to whom can she complain?

Problem 28.2

Rock musician Ice Scream contracted with Concert Promoter, Inc. to headline its Fourth of July “Freedom in the Park” all-day concert. On June 1, however, Mr. Scream was approached by representatives of the United Nations who asked him to become a celebrity “Peace Ambassador” and tour formerly war-torn regions to raise awareness of UN relief programs. In a rare (for him, at least) moment of quiet introspection, Mr. Scream decided that “making a difference” was more important than fulfilling his contract, so he contacted former bandmate Banan Asplit and asked him to take over the concert gig. Asplit was about as famous as Scream, and they had fairly similar audience profiles.

a. Concert Promoter was not happy with this turn of events. He demanded that Scream perform. Would Scream be in breach of contract if he continued to refuse to perform? Why or why not?

b. Suppose instead that Promoter consented. Scream headed off on his Peace Ambassador tour, but when the concert date rolled around, Asplit was a no-show, much to the embarrassment of Concert Promoter, which had to provide refunds to many angry concert-goers. Who is liable to Promoter—Scream, Asplit, or both? Explain your answer.

Problem 28.3

Olivia owns Purpleacre, a plot of land that is desirable for commercial development (despite it being not being nearly as popular as Blackacre). On March 1, Olivia signed a contract promising to convey Purpleacre to Ashton on June 1 for \$250,000, which Ashton paid up front. Because Olivia and Ashton wanted to save

money on legal fees, they found an employment contract on the internet and modified it themselves until they were satisfied it would work as a real estate contract. Among other provisions, the Olivia-and-Ashton contract contained language that expressly “prohibits assignment of this contract by any party” and further provides that “any assignment, delegation, or attempted assignment or delegation of any part of this agreement is *void ab initio*.”

On April 1, Ashton and Becker signed a document entitled “Contractual Assignment of Rights” in which Ashton sold to Becker in exchange for \$300,000 “any and all of Ashton’s rights under that certain real estate contract with Olivia dated March 1 for the conveyance of Purpleacre.” Olivia was completely unaware of the agreement between Ashton and Becker.

When the June 1 closing date rolled around, Olivia announced that she did not want to sell Purpleacre at all, and that she certainly would not sell it to Becker, with whom she does not even have a contract. Olivia says that she is quite willing to refund the \$250,000 if she can figure out to whom she owes it. What result if Becker sues Olivia, seeking a decree of specific performance requiring Olivia to convey Purpleacre to him? Why? Be sure to consider Restatement (Second) of Contracts section 322 in connection with your answer.