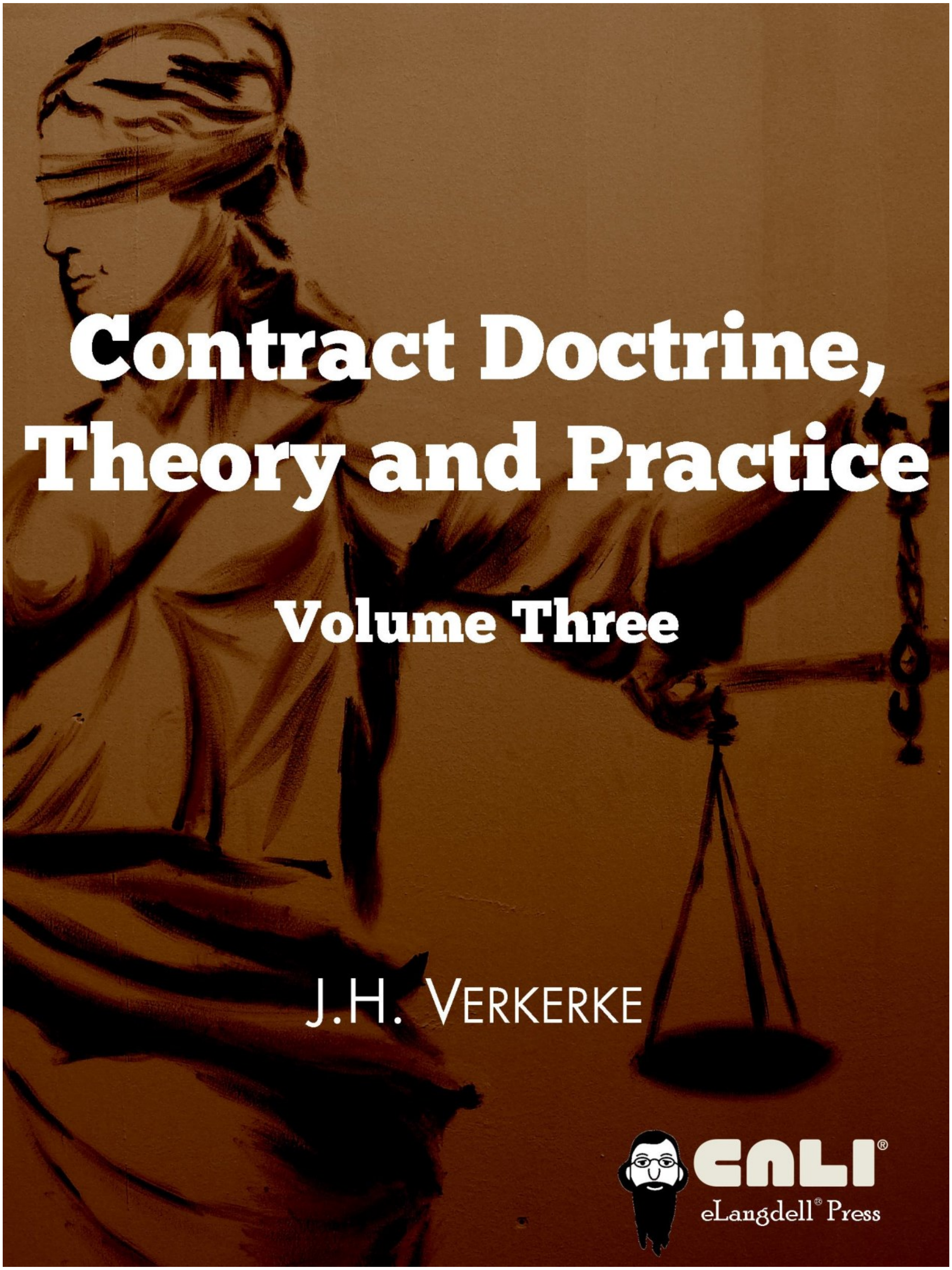
Contract Doctrine,
Theory and Practice
Volume Three
J.H. Verkerke
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Contract Doctrine, Theory & Practice

Volume Three

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About the Author

Before he received his law degree in 1990, J. H. (Rip) Verkerke earned a master's of philosophy in economics. Verkerke joined the Law School faculty in 1991 and teaches employment law, employment discrimination law, contracts and a seminar on law and economics.

While at Yale, Verkerke was articles editor and articles administrator for the *Yale Law Journal* and held a number of fellowships, including the John M. Olin Fellowship in Law, Economics, and Public Policy. After graduation, he clerked for Judge Ralph K. Winter Jr. of the U.S. Court of Appeals for the Second Circuit.

In June 1996 Verkerke received a three-year grant from the University's Academic Enhancement Program to establish the Program for Employment and Labor Law Studies at the Law School. He served as visiting professor of law at the University of Texas at Austin in the fall of 1997. Verkerke also participated in an ABA project to draft a new labor code for the transitional government of Afghanistan. In 2007, Verkerke received an All-University Teaching Award from UVA, and in 2011, he was selected as an inaugural member of the University Academy of Teaching.

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Preface

These teaching materials are a work-in-progress. Our reading assignments this semester will include all of the elements that make up a conventional casebook. You will read judicial opinions, statutory provisions, academic essays, and hypotheticals. You will puzzle over common law doctrines and carefully parse statutes. We will try to develop theories that can predict and justify the patterns of judicial decisions we observe.

Unlike a conventional casebook, however, I have selected each element of the readings myself. We will start at the beginning of these materials, read each assignment in order, and finish at the end. All of the reading assignments are also self-contained. When I ask you to read a statutory section or a portion of the Restatement, it will appear in the text at the point where you should read it. In addition, we will cover the entire set of materials. You will not spend the semester hauling around hundreds of extra pages that we have no time to read or discuss. At the end of each section, you will find discussion questions that track very closely the questions that I will ask during our class time together. Finally, the pages themselves are formatted to make reading easier and to give you plenty of space to take notes and mark up the text.

Our class also will use an online collaboration site to enrich and extend class discussions. This site will provide links to additional legal sources as well as questions for class discussion, practice problems, explanatory notes, and a discussion forum. The site will develop and evolve in response to your needs and interests. If you have any suggestions for changes or additions to these materials, I invite you to talk with me or post your ideas to our collaboration site.

Why study contract law?

The first semester of law school is mostly about learning to speak a new legal language (but emphatically not "legalese"), to formulate and evaluate legal arguments, to become comfortable with the distinctive style of legal analysis. We could teach these skills using almost any legal topic. But we begin the first-year curriculum with subjects that pervade the entire field of law. Contract principles have a long history and they form a significant part of the way that lawyers think about many legal problems. As you will discover when you study insurance law, employment law, family law, and dozens of other practice areas, your knowledge of contract doctrine and theory will be invaluable.

Why collaborative teaching materials?

The ultimate goal of this project is to involve many professors in producing a library of materials for teaching contracts (and other subjects). For the moment, I will be solely responsible for collecting public domain content and generating problems and explanatory essays. These embryonic reading materials will grow and evolve as I use and expand them and as other professors join in producing additional content. I gratefully acknowledge the extraordinary work of my talented research assistants who have been instrumental in helping me to put these materials together. Thanks to Sarah Bryan, Mario Lorello, Elizabeth Young, Vishal Phalgoo, Valerie Barker and Jim Sherwood.

I believe that it is equally important to involve students in the ongoing process of refining and improving how we teach legal subjects. Our collaboration site will provide a platform for student-generated content and lively dialogue. With your enthusiastic engagement, we will finish the semester with an excellent understanding of contracts and a useful collection of reference materials. I invite each of you to join us for what will be a challenging, sometimes frustrating, but ultimately rewarding, intellectual journey.

VI. Identifying and Interpreting the Terms of an Agreement

When contractual relations break down, parties frequently discover that they disagree both about which terms have become part of their agreement and about how to interpret those terms. We have already seen how the common law last shot rule and UCC § 2-207 determine whose terms govern after a "battle of the forms." In this section, we examine a broader set of doctrines concerning the content and meaning of a contract.

As you read these materials, it will be helpful to bear in mind that a fundamental tension afflicts judicial efforts to identify and interpret the terms of an agreement. The question in every case is whether to hew closely to the language contained in the parties' written agreement or instead to consider evidence of prior or contemporaneous oral agreements, trade customs, the parties' course of dealing under earlier contracts, and their experience performing the current contract. Early common law decisions tended to exclude much of this contextual evidence. However, many critics have observed that the traditional formalist emphasis on the text of the written agreement often prevents enforcement of oral promises or understandings between the parties that were assuredly part of their agreement.

More recently, courts have developed rules that permit them to consider a much wider range of contextual evidence. Their goal has been to eliminate formal obstacles to discovering the true intentions of the parties. Both the Restatement (Second) of Contracts § 216 and UCC § 2-202 embody this more permissive attitude. However, a neo-formalist critique of the contextualist approach points out that parties often use written agreements to make their obligations more precise and to narrow the scope of potential disagreement about terms and meaning. Courts frustrate this goal when they permit contextual evidence to undermine the comparative certainty of a writing.

Although these competing concerns apply equally to both identifying and interpreting terms, the cases that follow focus on the problem of identifying which terms will become part of a contract. The common law parol evidence rule and UCC § 2-202 provide the legal framework within which this issue is analyzed.

1 The Common Law Parol Evidence Rule

Courts use the common law parol evidence rule to decide whether a party may try to prove contract terms beyond those contained in a written agreement. The traditional textualist approach to this question—the so-called "four corners test"—asked simply whether the written contract appeared complete on its face. If so, both parties would be barred from introducing evidence of any prior or contemporaneous agreement about the same transaction. Contemporary case law has embraced a far more permissive standard that asks instead whether the alleged additional terms "would naturally have been excluded" from the writing. See Restatement (Second) of Contracts § 216. In the majority of US jurisdictions, the common law thus has evolved from a relatively strict parol evidence rule to a comparatively lax standard that is far more likely to permit parties to offer evidence of informal agreements to vary the terms of a writing.

Despite this evolution towards contextualism, constraints remain. The modern parol evidence rule still limits proof of additional terms. It is convenient to distinguish two stages of analysis. Courts ask first whether the parties' written agreement is partially or totally "integrated" and then whether the proffered additional term is "consistent" with the written terms.

The touchstone for *integration* is an inquiry into whether the parties intended the writing to be a final and exclusive statement of their agreement. The written contract is fully (or "completely") integrated if it was meant to exclude all prior or contemporaneous understandings between the parties, and it is partially integrated if it is the final statement of only some of the terms of their agreement. An express “merger clause” stating that the writing will be the final and exclusive statement of the parties’ agreement is by far the most common basis for finding full integration. The test of *consistency* bars proof of terms that contradict or are inconsistent with the writing. At least in theory, both integration and consistency thus filter out those additional terms that are unlikely to have been part of the parties’ agreement.

As you will discover in reading the cases that follow, applying the rules for integration and consistency is a remarkably uncertain enterprise. Try to discern where each court falls on the continuum from formalist textualism to permissive contextualism. And see if you agree with the underlying policy arguments that animate the various opinions.

1.1 Principal Case – Mitchill v. Lath

Mitchill v. Lath

Court of Appeals of New York

247 N.Y. 377, 160 N.E. 646 (1928)

ANDREWS, J.

[1] 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.

[2] This requires a discussion of the parol evidence rule—a rule of law which defines the limits of the contract to be construed. (Glackin v. Bennett, 226 Mass. 316.) It is more than a rule of evidence and oral testimony even if admitted will not control the written contract (O'Malley v. Grady, 222 Mass. 202), unless admitted without objection. (Brady v. Nally, 151 N. Y. 258.) 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 (sec. 637) 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." 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.

[3] 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 present 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) it was held that a parol warranty might not be shown although no warranties were contained in the writing.

[4] 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.

[5] 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?

[6] 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.

[7] 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, 292); *Thomas v. Scutt* (127 N. Y. 133); *Eighmie v. Taylor* (98 N. Y. 288); *Stowell v. Greenwich Ins. Co.* (163 N. Y. 298); *Newburger v. American Surety Co.* (242 N. Y. 134); *Love v. Hamel* (59 App. Div. 360); *Daly v. Piza* (105 App. Div. 496); *Seitz v. Brewers Refrigerating Co.* (141 U. S. 510); *American Locomotive Co. v. Nat. Grocery Co.* (226 Mass. 314); *Doyle v. Dixon* (12 Allen, 576). Of these citations, *Johnson v. Oppenheim* and the two in the Appellate Division relate to collateral contracts said to have been the inducing cause of the main contract. They refer to leases. A similar case is *Wilson v. Deen* (74 N. Y. 531). 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), 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.

[8] 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* (L. R. 8 Ch. App. 756) and *Morgan v. Griffith* (L. R. 6 Exch. 70), where although there was a written lease a collateral agreement of the landlord to reduce the game was admitted. In this State *Wilson v. Deen* might lead to the contrary result. Neither are they approved in New Jersey (*Naumberg v. Young*, 15 Vroom, 331). Nor in view of later cases in this court can *Batterman v. Pierce* (3 Hill, 171) be considered an authority. A line of cases in Massachusetts, of which *Durkin v. Cobleigh* (156 Mass. 108) 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. This may be cause for an exception. Here we deal with 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.

[9] Finally there is the case of *Chapin v. Dobson* (78 N. Y. 74, 76). This is acknowledged to be on the border line and is rarely cited except to be distinguished. Assuming the premises, however, the court was clearly right. There was nothing on the face of the written contract, it said, to show that it intended to express the entire agreement. And there was a finding, sustained by evidence, that there was an entire contract, only part of which was reduced to writing. This being so, the contract as made might be proved.

[10]It is argued that what we have said is not applicable to the case as presented. The collateral agreement was made with the plaintiff. The contract of sale was with her husband and no assignment of it from him appears. Yet the deed was given

to her. It is evident that here was a transaction in which she was the principal from beginning to end. We must treat the contract as if in form, as it was in fact, made by her.

[11]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).

[12]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.

[13]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." See Judge Andrews' citation from WILLISTON ON CONTRACTS, section 637.

[14]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.

[15]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.

[16]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. 288.) 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." (WIGMORE ON EVIDENCE [2d ed.], section 2430.)

[17]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.

[18]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.

[19]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.

[20]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.

CARDOZO, CH. J., POUND, KELLOGG AND O'BRIEN, JJ., CONCUR WITH ANDREWS, J.; LEHMAN, J., DISSENTS IN OPINION IN WHICH CRANE, J., CONCURS.

1.2 Principal Case – *Masterson v. Sine*

Masterson v. Sine
Supreme Court of California
68 Cal. 2d. 222, 436 P.2d 561 (1968)

TRAYNOR, CHIEF JUSTICE.

[1] Dallas Masterson and his wife Rebecca owned a ranch as tenants in common. On February 25, 1958, they conveyed it

to Medora and Lu Sine by a grant deed "Reserving unto the Grantors herein an option to purchase the above described property on or before February 25, 1968" for the "same consideration as being paid heretofore plus their depreciation value of any improvements Grantees may add to the property from and after two and a half years from this date." Medora is Dallas' sister and Lu's wife. Since the conveyance Dallas has been adjudged bankrupt. His trustee in bankruptcy and Rebecca brought this declaratory relief action to establish their right to enforce the option.

[2] The case was tried without a jury. Over defendants' objection the trial court admitted extrinsic evidence that by "the same consideration as being paid heretofore" both the grantors and the grantees meant the sum of $50,000 and by "depreciation value of any improvements" they meant the depreciation value of improvements to be computed by deducting from the total amount of any capital expenditures made by defendants grantees the amount of depreciation allowable to them under United States income tax regulations as of the time of the exercise of the option.

[3] The court also determined that the parol evidence rule precluded admission of extrinsic evidence offered by defendants to show that the parties wanted the property kept in the Masterson family and that the option was therefore personal to the grantors and could not be exercised by the trustee in bankruptcy.

[4] The court entered judgment for plaintiffs, declaring their right to exercise the option, specifying in some detail how it could be exercised, and reserving jurisdiction to supervise the manner of its exercise and to determine the amount that plaintiffs will be required to pay defendants for their capital expenditures if plaintiffs decide to exercise the option.

[5] Defendants appeal. They contend that the option provision is too uncertain to be enforced and that extrinsic evidence as to its meaning should not have been admitted.

The trial court properly refused to frustrate the obviously declared intention of the grantors to reserve an option to repurchase by an overly meticulous insistence on completeness and clarity of written expression. (See *California Lettuce Growers v. Union Sugar Co.* (1955) 45 Cal.2d 474, 481, 289 P.2d 785, 49 A.L.R.2d 496; *Rivers v. Beadle* (1960) 183 Cal.App.2d 691, 695-697, 7 Cal.Rptr. 170.) It properly admitted extrinsic evidence to explain the language of the deed (*Nofziger v. Holman* (1964) 61 Cal.2d 526, 528, 39 Cal.Rptr. 384, 393 P.2d 696; *Barham v. Barham* (1949) 33 Cal.2d 416, 422-423, 202 P.2d 289; *Union Oil Co. v. Union Sugar Co.* (1948) 31 Cal.2d 300, 306, 188 P.2d 470; *Schmidt v. Macco Construction Co.* (1953) 119 Cal.App.2d 717, 730, 260 P.2d 230; see Farnsworth, *'Meaning' in the Law of Contracts* (1967) 76 YALE L.J. 939, 959-965; Corbin, *The Interpretation of Words and the Parol Evidence Rule* (1965) 50 CORNELL L.Q. 161) to the end that the consideration for the option would appear with sufficient certainty to permit specific enforcement (see *McKeon v. Santa Claus of California, Inc.* (1964) 230 Cal.App.2d 359, 364, 41 Cal.Rptr. 43; *Burrow v. Timmsen* (1963) 223 Cal.App.2d 283, 288, 35 Cal.Rptr. 668, 100 A.L.R.2d 544). The trial court erred, however, in excluding the extrinsic evidence that the option was personal to the grantors and therefore nonassignable.

[6] 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. (*Pollyanna Homes, Inc. v. Berney* (1961) 56 Cal.2d 676, 679-680, 16 Cal.Rptr. 345, 365 P.2d 401; *Hale v. Bohannon* (1952) 38 Cal.2d 458, 465, 241 P.2d 4; see 3 CORBIN, CONTRACTS (1960) § 573, p. 357; REST., CONTRACTS (1932) §§ 228 (and com. a), 237; Code Civ.Proc., § 1856; Civ.Code, § 1625.) 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. (*Hulse v. Juillard Fancy Foods Co.* (1964) 61

Cal.2d 571, 573, 39 Cal.Rptr. 529, 394 P.2d 65; *Schwartz v. Shapiro* (1964) 229 Cal.App.2d 238, 250, 40 Cal.Rptr. 189; *Mangini v. Wolfschmidt, Ltd.* (1958) 165 Cal.App.2d 192, 200-201, 331 P.2d 728; REST., CONTRACTS (1932) § 239.)

[7] 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." (See 3 CORBIN, CONTRACTS (1960) § 578, p. 411.) 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. (See 3 CORBIN, CONTRACTS (1960) §§ 582-584; MCCORMICK, EVIDENCE (1954) § 216, p. 441; 9 WIGMORE, EVIDENCE (3d ed. 1940) § 2430, p. 98, § 2431, pp. 102-103; WITKIN, CAL. EVIDENCE (2d ed. 1966) § 721; *Schwartz v. Shapiro*, *supra*, 229 Cal.App.2d 238, 251, fn. 8, 40 Cal.Rptr. 189; *contra*, 4 WILLISTON, CONTRACTS (3d ed. 1961) § 633, pp. 1014-1016.)

[8] California cases have stated that whether there was an integration is to be determined solely from the face of the instrument (e.g., *Thoroman v. David* (1926) 199 Cal. 386, 389-390, 249 P. 513; *Heffner v. Gross* (1919) 179 Cal. 738, 742-743, 178 P. 860; *Gardiner v. McDonogh* (1905) 147 Cal. 313, 318-321, 81 P. 964; *Harrison v. McCormick* (1891) 89 Cal. 327, 330, 26 P. 830), and that the question for the court is whether it 'appears to be a complete…agreement….' (See *Ferguson v. Koch* (1928) 204 Cal. 342, 346, 268 P. 342, 344, 58 A.L.R. 1176; *Harrison v. McCormick*, *supra*, 89 Cal. 327, 330, 26 P. 830.) Neither of these strict formulations of the rule, however, has been consistently applied. The requirement that the writing must

appear incomplete on its face has been repudiated in many cases where parol evidence was admitted "to prove the existence of a separate oral agreement as to any matter on which the document is silent and which is not inconsistent with its terms"—even though the instrument appeared to state a complete agreement. (*E.g.*, *American Industrial Sales Corp. v. Airscope, Inc.* (1955) 44 Cal.2d 393, 397, 282 P.2d 504, 506, 49 A.L.R.2d 1344; *Stockburger v. Dolan* (1939) 14 Cal.2d 313, 317, 94 P.2d 33, 128 A.L.R. 83; *Crawford v. France* (1933) 219 Cal. 439, 443, 27 P.2d 645; *Buckner v. A. Leon & Co.* (1928) 204 Cal. 225, 227, 267 P. 693; *Sivers v. Sivers* (1893) 97 Cal. 518, 521, 32 P. 571; *cf. Simmons v. California Institute of Technology* (1949) 34 Cal.2d 264, 274, 209 P.2d 581.) Even under the rule that the writing alone is to be consulted, it was found necessary to examine the alleged collateral agreement before concluding that proof of it was precluded by the writing alone. (See 3 CORBIN, CONTRACTS (1960) § 582, pp. 444-446.) It is therefore evident that "The conception of a writing as wholly and intrinsically self-determinative of the parties' intent to make it a sole memorial of one or seven or twenty-seven subjects of negotiation is an impossible one." (9 WIGMORE, EVIDENCE (3d ed. 1940) § 2431, p. 103.) For example, a promissory note given by a debtor to his creditor may integrate all their present contractual rights and obligations, or it may be only a minor part of an underlying executory contract that would never be discovered by examining the face of the note.

[9] 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. (*Germain Fruit Co. v. J. K. Armsby Co.* (1908) 153 Cal. 585, 595, 96 P. 319.) 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. (*Germain Fruit Co. v. J. K. Armsby Co.*, *supra*, 153 Cal. 585, 596, 96 P. 319; *Mitchill v. Lath* (1928) 247 N.Y. 377, 388, 160 N.E. 646, 68 A.L.R. 239 (dissenting opinion by Lehman, J.); see 9 WIGMORE, EVIDENCE (3d ed. 1940) § 2431, p. 102; Murray, *The Parol Evidence Rule: A Clarification* (1966) 4 DUQUESNE L. REV. 337, 338-339.) 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. (See MCCORMICK, EVIDENCE (1954) § 210.) He recognizes, however, that if this theory were adopted in disregard of all other considerations, it would lead to the exclusion of testimony concerning oral agreements whenever there is a writing and thereby often defeat the true intent of the parties. See MCCORMICK, *op. cit. supra*, § 216, p. 441.)

[10]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 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." (Italics added; see MCCORMICK, EVIDENCE (1954) § 216, p. 441; see also 3 CORBIN, CONTRACTS (1960) § 583, p. 475, § 594, pp. 568-569; 4 WILLISTON, CONTRACTS (3d ed. 1961) § 638, pp. 1039-1045.) 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." (Com. 3, § 2-202, italics added.)[i]

[11]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.[ii] (See 3 CORBIN, CONTRACTS (1960) § 587; 4 WILLISTON, CONTRACTS (3d ed. 1961) § 645; 70 A.L.R. 752, 759 (1931); 68 A.L.R. 245 (1930).) 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.

[12]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* (1927) 200 Cal. 434, 450, 253 P. 718; *Altman v. Blewett* (1928) 93 Cal. App. 516, 525, 269 P. 751.) 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 *American Industrial Sales Corp. v. Airscope, Inc.*, *supra*, 44 Cal.2d 393, 397-398, 282 P.2d 504, we held it proper to admit parol evidence of a contemporaneous

collateral agreement as to the place of payment of a note, even though it contradicted the presumption that a note, silent as to the place of payment, is payable where the creditor resides. (For other examples of this approach, see *Richter v. Union Land etc. Co.* (1900) 129 Cal. 367, 375, 62 P. 39 (presumption of time of delivery rebutted by parol evidence); *Wolters v. King* (1897) 119 Cal. 172, 175-176, 51 P. 35 (presumption of time of payment rebutted by parol evidence); *Mangini v. Wolfschmidt, Ltd.*, *supra*, 165 Cal.App.2d 192, 198-201, 331 P.2d 728 (presumption of duration of an agency contract rebutted by parol evidence); *Zinn v. Ex-Cell-O Corp.* (1957) 148 Cal.App.2d 56, 73-74, 306 P.2d 1017; see also REST., CONTRACTS, § 240, com. c.)[iii] Of course a statute may preclude parol evidence to rebut a statutory presumption. (E.g., *Neff v. Ernst* (1957) 48 Cal.2d 628, 635, 311 P.2d 849 (commenting on Civ.Code, § 1112); *Kilfoy v. Fritz* (1954) 125 Cal.App.2d 291, 293-294, 270 P.2d 579 (applying Deering's Gen.Laws 1937, Act 652, § 15a; see also Com.Code, § 9-318, subd. (4).) Here, however, there is no such statute. In the absence of a controlling statute the parties may provide that a contract right or duty is nontransferable. (*La Rue v. Groezinger* (1890) 84 Cal. 281, 283, 24 P. 42; *Benton v. Hofmann Plastering Co.* (1962) 207 Cal.App.2d 61, 68, 24 Cal.Rptr. 268; *Parkinson v. Caldwell* (1954) 126 Cal.App.2d 548, 552-553, 272 P.2d 934; see 4 CORBIN, CONTRACTS (1951) §§ 872-873.) Moreover, even when there is no explicit agreement—written *or* oral—that contractual duties shall be personal, courts will effectuate presumed intent to that effect if the circumstances indicate that performance by [a] substituted person would be different from that contracted for. (*Farmland Irrigation Co. v. Dopplmaier* (1957) 48 Cal.2d 208, 222, 308 P.2d 732, 66 A.L.R.2d 590; *Prichard v. Kimball* (1923) 190 Cal. 757, 764-765, 214 P. 863; *Simmons v. Zimmerman* (1904) 144 Cal. 256, 260-261, 79 P. 451; *La Rue v. Groezinger*, *supra*, 84 Cal. 281, 285, 24 P. 42; *Coykendall v. Jackson* (1936) 17 Cal.App.2d 729, 731, 62 P.2d 746; see 4 CORBIN, CONTRACTS (1951) § 865; 3 WILLISTON, CONTRACTS (3d ed. 1960) § 412, pp. 32-33; REST., CONTRACTS (Tent. Draft No. 3, 1967) § 150(2).)

[13]In *Standard Box Co. v. Mutual Biscuit Co.* (1909) 10 Cal.App. 746, 750, 103 P. 938, 940, the rationale of *Gardiner v. McDonogh* was extended to exclude evidence of an agreement for a time of performance other than the "reasonable time" implied by law in a situation where the writing, although stating no time of performance, was "clear and complete when aided by that which is imported into it by legal implication." This decision was simply an application of the then-current theory regarding integration. The court regarded the instrument as a complete integration, and it therefore precluded proof of collateral agreements. Since it is now clear that integration cannot be determined from the writing alone, the decision is not authoritative insofar as it finds a complete integration. There is no reason to believe that the court gave any independent significance to implied terms. Had the court found from the writing alone that there was no integration, there is nothing to indicate that it would have excluded proof contrary to terms it would have otherwise presumed.

[14]In *Buffalo Arms, Inc. v. Remler Co.* (1960) 179 Cal.App.2d 700, 710, 4 Cal.Rptr. 103, the court refused to admit parol evidence showing a collateral oral agreement that a buyer would have more than the 'reasonable time' presumed by law to refuse goods, but the decision is based on a conclusion that the writing on its face was a complete expression of the agreement. In *La France v. Kashishian* (1928) 204 Cal. 643, 645, 269 P. 655, and *Fogler v. Purkiser* (1932) 127 Cal.App. 554, 559-560, 16 P.2d 305, there are no clear findings concerning the completeness of the writings; but the argument in each case is borrowed from the *Standard Box Co.* decision and thus implies a finding of a complete integration. *Calpetro Producers Syndicate v. C. M. Woods Co.* (1929) 206 Cal. 246, 247-248, 252, 274 P. 65, relies on *Standard Box Co.* and expressly finds a complete integration.

[15]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.

[16]The judgment is reversed.

PETERS, TOBRINER, MOSK, AND SULLIVAN, JJ., CONCUR.

Dissenting Opinion

Burke, Justice

[17] I dissent. The majority opinion:

(1) Undermines the parol evidence rule as we have known it in this state since at least 1872[iv] 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.

[18] The opinion permits defendants to establish by parol testimony that their grant[v] 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.

[19] 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.

[20] The court properly admitted parol evidence to explain the intended meaning of the "same consideration" and "depreciation value" phrases of the written option to purchase defendants' land, as the intended meaning of those phrases was not clear. However, there was nothing ambiguous about the *granting* language of the option and not the slightest suggestion in the document that the option was to be nonassignable. Thus, to permit such words of limitation to be added by parol is to *contradict* the absolute nature of the grant, and to directly violate the parol evidence rule.

[21] Just as it is unnecessary to state in a deed to "lot X" that the house located thereon goes with the land, it is likewise unnecessary to add to "I grant an option to Jones" the words "and his assigns" for the option to be assignable. As hereinafter emphasized in more detail, California statutes expressly declare that it is assignable, and only if I add language in writing showing my intent to withhold or restrict the right of assignment may the grant be so limited. Thus, to seek to restrict the grant by parol is to contradict the written document in violation of the parol evidence rule.

[22] The majority opinion arrives at its holding via a series of false premises which are not supported either in the record of this case or in such California authorities as are offered.

[The remainder of the dissent presents a point-by-point refutation of the majority's reasoning. Although I have elected to reprint these pages for the benefit of those students who might find the analysis interesting, you should feel free to skim this material if you are at all pressed for time (or prone to drowsiness). To say that Justice Burke's writing style is somewhat soporific would be to dramatically understate its likely effect on your level of alertness. Forewarned is forearmed.]

[23] The parol evidence rule is set forth in clear and definite language in the statutes of this state. (Civ.Code, § 1625; Code Civ.Proc., § 1856.) It "is not a rule of evidence but is one of substantive law….The rule as applied to contracts is simply that as a

matter of substantive law, a certain act, the act of embodying the complete terms of an agreement in a writing (the 'integration'), Becomes the contract of the parties." (Hale v. Bohannon (1952) 38 Cal.2d 458, 465, 241 P.2d 4, 7(1, 2), quoting from In re Estate of Gaines (1940) 15 Cal.2d 255, 264-265, 100 P.2d 1055.) The rule is based upon the sound principle that the parties to a written instrument, after committing their agreement to or evidencing it by the writing, are not permitted to add to, vary or contradict the terms of the writing by parol evidence. As aptly expressed by the author of the present majority opinion, speaking for the court in Parsons v. Bristol Development Co. (1965) 62 Cal.2d 861, 865(2), 44 Cal.Rptr. 767, 402 P.2d 839, and in Coast Bank v. Minderhout (1964) 61 Cal.2d 311, 315, 38 Cal.Rptr. 505, 507, 392 P.2d 265, 267, such evidence is "admissible to *interpret* the instrument, but not to give it a meaning to which it is not reasonably susceptible." (Italics added.) Or, as stated by the same author, concurring in Laux v. Freed (1960) 53 Cal.2d 512, 527, 2 Cal.Rptr. 265, 273, 348 P.2d 873, 881, "extrinsic evidence is not admissible to add to, *detract* from, or vary its terms." (Italics added.)

[24] At the outset the majority in the present case reiterate[vi] that the rule against contradicting or varying the terms of a writing remains applicable when only part of the agreement is contained in the writing, and parol evidence is used to prove elements of the agreement not reduced to writing. But having restated this established rule, the majority opinion inexplicably proceeds to subvert it.

[25] Each of the three cases cited by the majority (fn. 3, Ante) holds that although parol evidence is admissible to prove the parts of the contract not put in writing, it is *not* admissible to vary or *contradict* the writing *or* prove collateral a*greements* which are *inconsistent* therewith. The meaning of this rule (and the application of it found in the cases) is that if the asserted unwritten elements of the agreement would contradict, add to, detract from, vary or be inconsistent with the written agreement, then such elements may not be shown by parol evidence.

[26] The contract of sale and purchase of the ranch property here involved was carried out through a title company upon written escrow instructions executed by the respective parties after various preliminary negotiations. The deed to defendant grantees, in which the grantors expressly reserved an option to repurchase the property within a ten-year period and upon a specified consideration, was issued and delivered in consummation of the contract. In neither the written escrow instructions nor the deed containing the option is there any language even suggesting that the option was agreed or intended by the parties to be personal to the grantors, and so nonassignable. The trial judge, on at least three separate occasions, correctly sustained objections to efforts of defendant optionors to get into evidence the testimony of Dallas Masterson (the bankrupt holder of the option) that a part of the agreement of sale of the parties was that the option to repurchase the property was personal to him, and therefore unassignable for benefit of creditors. But the majority hold that that testimony should have been admitted, thereby permitting defendant optionors to limit, detract from and contradict the plain and unrestricted terms of the written option in clear violation of the parol evidence rule and to open the door to the perpetration of fraud.

[27] Options are property, and are widely used in the sale and purchase of real and personal property. One of the basic incidents of property ownership is the right of the owner to sell or transfer it. The author of the present majority opinion, speaking for the court in Farmland Irrigation Co. v. Dopplmaier (1957) 48 Cal.2d 208, 222, 308 P.2d 732, 740, 66 A.L.R.2d 590, put it this way: "The statutes in this state clearly manifest a policy in favor of the free transferability of all types of property, including rights under contracts."[vii] (Citing Civ.Code, §§ 954, 1044, 1458;[viii] see also 40 Cal.Jur.2d 289-291, and cases there cited.) These rights of the owner of property to transfer it, confirmed by the cited code sections, are elementary rules of substantive law and not the mere disputable presumptions which the majority opinion in the present case would make of them. Moreover, the right of transferability applies to an option to purchase, unless there are words of limitation in the option

forbidding its assignment or showing that it was given because of a peculiar trust or confidence reposed in the optionee. (Mott v. Cline (1927) 200 Cal. 434, 450(11), 253 P. 718; Prichard v. Kimball (1923) 190 Cal. 757, 764-765(4, 5), 214 P. 867; Altman v. Blewett (1928) 93 Cal.App. 516, 525(3), 269 P. 751; see also 5 Cal.Jur.2d 393, 395-396, and cases there cited.) Thus, in *Prichard* the language of the *document* itself (a written, *expressly* nonassignable lease, with option to buy) was held to establish the trust or confidence reposed in the optionee and so to negate assignability of the option.

[28] The right of an optionee to transfer his option to purchase property is accordingly one of the basic rights which accompanies the option unless limited under the language of the option itself. To allow an optionor to resort to parol evidence to support his assertion that the written option is not transferable is to authorize him to limit the option by attempting to restrict and reclaim rights with which he has already parted. A clearer violation of two substantive and basic rules of law—the parol evidence rule and the right of free transferability of property—would be difficult to conceive.

[29] The majority opinion attempts to buttress its approach by asserting that "California cases have stated that whether there was an integration is to be determined solely from the face of the instrument (citations), and that the question for the court is whether it 'appears to be a complete…agreement….'" (citations), but that "Neither of these strict formulations of the rule…has been consistently applied."

[30] The majority's claim of inconsistent application of the parol evidence rule by the California courts fails to find support in the examples offered. First, the majority opinion asserts that "The requirement that the writing must appear incomplete on its face has been repudiated in many cases where parol evidence was admitted 'to prove the existence of a separate oral agreement as to any matter on which the document is silent and which is not inconsistent with its terms'—even though the instrument appeared to state a complete agreement. (Citations.)" But an examination of the cases cited in support of the quoted statement discloses that on the contrary in

every case which is pertinent here (with a single exception) the writing was obviously incomplete on its face.[ix] In the one exception (Stockburger v. Dolan (1939) 14 Cal.2d 313, 317, 94 P.2d 33, 128 A.L.R. 83) it was held that lessors under a lease to drill for oil in an area zoned against such drilling should be permitted to show by parol that the lessee had contemporaneously agreed orally to seek a variance—an agreement which, as the opinion points out, did not contradict the written contract. But what is additionally noteworthy in *Stockburger*, and controlling here, is the further holding that lessors could not show by parol that lessee had orally agreed that a lease provision suspending payment of rental under certain circumstances would not apply during certain periods of time—as "evidence to that effect would vary the terms of the contract in that particular…." (P. 317(5) of 14 Cal.2d p. 35 of 94 P.2d.)

[31] In further pursuit of what would appear to be nonexistent support for its assertions of inconsistency in California cases, the majority opinion next declares (p. 548) that "Even under the rule that the writing alone is to be consulted, it was found necessary to examine the alleged collateral agreement before concluding that proof of it was precluded by the writing alone. (See 3 Corbin, Contracts (1960) § 582, pp. 444-446.)" Not only are *no* California cases cited by the majority in supposed support for the quoted declaration (offered by the majority as an example of inconsistent applications of the parol evidence rule by California courts), but 3 Corbin, Contracts, which the majority do cite, likewise refers to *no* California cases, and makes but scanty citation to any cases whatever. In any event, in what manner other than by "examining" an alleged collateral agreement is it possible for a court to rule upon the admissibility of testimony or upon an offer of proof with respect to such agreement?

[32] The majority opinion has thus demonstrably failed to substantiate its next utterance (p. 548) that "The conception of a writing as wholly and intrinsically self-determinative of the parties' intent to make it a sole memorial of one or seven or twenty-seven subjects of negotiation is an impossible one," citing 9 Wigmore, Evidence (3d ed. 1940) section 2431, page 103, whose views on the

subject were Rejected by this court as early as 1908 in Germain Fruit Co. v. J. K. Armsby Co., 153 Cal. 585, 595, 96 P. 319, which, indeed, is also cited by the majority in the present case. And the example given, that of a promissory note, is obviously specious. Rarely, if ever, does a promissory note given by a debtor to his creditor integrate all their agreements (that is not the purpose it serves); it may or it may not integrate all their present contractual rights and obligations; but relevant to the parol evidence rule, at least until the advent of the majority opinion in this case, alleged collateral agreements which would vary or contradict the terms and conditions of a promissory note may *not* be shown by parol. (Bank of America etc. Ass'n v. Pendergrass (1935) 4 Cal.2d 258, 263-264(6), 48 P.2d 659.)

[33] Upon this structure of incorrect premises and unfounded assertions the majority opinion arrives at its climax: The pronouncement of "several policies [to] be accommodated…*[i]n formulating the rule governing parol evidence.*" (Italics added.)[x] Two of the "policies" as declared by the majority are: Written evidence is more accurate than human memory[xi] fraud or unintentional invention by interested witnesses may well occur.

[34] I submit that these purported "policies" are in reality two of the basic and obvious reasons for adoption by the legislature of the parol evidence rule as the policy in this state. Thus the speculation of the majority concerning the views of various writers on the subject and the advisability of following them in this state is not only superfluous but flies flatly in the face of established California law and policy. It serves only to introduce uncertainty and confusion in a field of substantive law which was codified and made certain in this state a century ago.

[35] However, despite the law which until the advent of the present majority opinion has been firmly and clearly established in California and relied upon by attorneys and courts alike, that parol evidence may *not* be employed to vary or contradict the terms of a written instrument, the majority now announce (p. 548) that such evidence "should be excluded only when the fact finder is *likely* to be misled," and that "The rule must therefore be based on the

credibility of the evidence." (Italics added.) But was it not, inter alia, to avoid misleading the fact finder, and to further the introduction of only the evidence which is most likely to *be* credible (the written document), that the Legislature adopted the parol evidence rule as a part of the substantive law of this state?

[36] Next, in an effort to implement this newly promulgated "credibility" test, the majority opinion offers a choice of two "standards": one, a "certainty" standard, quoted from the Uniform Commercial Code,[xii] and the other a "natural" standard found in the Restatement of Contracts,[xiii] and concludes that at least for purposes of the present case the "natural" viewpoint should prevail.

[37] This new rule, not hitherto recognized in California, provides that proof of a claimed collateral oral agreement is admissible if it is such an agreement as might *naturally* have been made a separate agreement by the parties under the particular circumstances. I submit that this approach opens the door to uncertainty and confusion. Who can know what its limits are? Certainly I do not. For example, in its application to this case who could be expected to divine as "natural" a separate oral agreement between the parties that the assignment, absolute and unrestricted on its face, was intended by the parties to be limited to the Masterson family?

[38] Or, assume that one gives to his relative a promissory note and that the payee of the note goes bankrupt. By operation of law the note becomes an asset of the bankruptcy. The trustee attempts to enforce it. Would the relatives be permitted to testify that by a separate oral agreement made at the time of the execution of the note it was understood that should the payee fail in his business the maker would be excused from payment of the note, or that, as here, it was intended that the benefits of the note would be personal to the payee? I doubt that trial judges should be burdened with the task of conjuring whether it would have been 'natural under those circumstances for such a separate agreement to have been made by the parties. Yet, under the application of the proposed rule, this is the task the trial judge would have, and in essence the situation presented in the instant case is no different.

[39] Under the application of the codes and the present case law, proof of the existence of such an agreement would not be permitted, "natural" or "unnatural." But conceivably, as loose as the new rule is, one judge might deem it natural and another judge unnatural.[xiv] And in each instance the ultimate decision would have to be made ("naturally") on a case-by-case basis by the appellate courts.

[40] In an effort to provide justification for applying the newly pronounced "natural" rule to the circumstances of the present case, the majority opinion next attempts to account for the silence of the writing in this case concerning assignability of the option, by asserting that "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." What difficulty would have been involved here, to add the words "this option is nonassignable"? The asserted "formalized structure of a deed" is no formidable barrier. The Legislature has set forth the requirements in simple language in section 1092 of the Civil Code. It is this: "I, A B, grant to C D all that real property situated in (naming county), State of California…described as follows: (describing it)." To this the grantor desiring to reserve an option to repurchase need only so state, as was done here. It is a matter of common knowledge that collateral agreements (such as the option clause here involved, or such as deed restrictions) are frequently included in deeds, without difficulty of any nature.

[41] To support further speculation, that "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," the majority assert that "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." (Italics added.) The facts of this case, however, do not support such claim of naivete. 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." (Italics added.) 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 naive family transaction postulated by the majority?

[42] The majority opinion then proceeds on the fallacious assertion that the right to transfer or to assign an option, if it contains no provisions forbidding transfer or indicating that performance involves elements personal to the parties, is a mere disputable presumption, and in purported support cites cases not one of which involves an option and in each of which the presumption which was invoked served to supply a missing but essential element of a complete agreement.[xv] As already emphasized hereinabove, the right of free transferability of property, including options, is one of the most fundamental tenets of substantive law, and the crucial distinction would appear self-evident between such a basic right on the one hand, and on the other hand the disputable evidentiary presumptions which the law has developed to supply terms lacking from a written instrument but essential to making it whole and complete. There is no such lack in the deed and the option reservation now at issue.

[43] The statement of the majority opinion that in the absence of a controlling statute the parties may provide that a contract right or duty is nontransferable, is of course true. Equally true is the next assertion that "even when there is no explicit agreement—written *or* oral—that contractual duties shall be personal, courts will effectuate a presumed intent to that effect if the circumstances indicate that performance by a substituted person would be different from that contracted for." But to apply the law of contracts for the rendering of personal services to the reservation of an option in a deed of real

estate calls for a misdirected use of the rule, particularly in an instrument containing not one word from which such "a presumed intent to that effect" could be gleaned. Particularly is the holding objectionable when the result is to upset established statutory and case law in this state that "circumstances" shown by parol may not be employed to contradict, add to or detract from, the agreement of the parties as expressed by them in writing. And once again the quoted pronouncement of the majority concerning the showing of "circumstances" by parol fails to find support in the cases they cite,[xvi] which relate to a patent license agreement, held to be assignable absent terms indicating a contrary intent; a contract to sell grapes, also held assignable; a contract which included language showing the intent that it be nonassignable; a contract to buy land held to be assignable because approval of title by the buyer was held not to be a personal privilege attaching only to the assignor; and to contracts for personal services.

[44] In Prichard v. Kimball, supra (1923) 190 Cal. 757, 764-765, 214 P. 863, next cited by the majority, the *written* contract contained language showing the intent that it be nonassignable (as already pointed out hereinabove). Simmons v. Zimmerman (1904) 144 Cal. 256, 260-261, 79 P. 451, held that a contract to buy land *was* assignable, as approval of title by the buyer is *not* a personal privilege attaching only to the assignor (the party to whom the seller agreed to sell). La Rue v. Groezinger has already been shown not to support the majority's proposition here. And the last case which the majority cite, Coykendall v. Jackson (1936) 17 Cal.App.2d 729, 731, 62 P.2d 746, involved a contract for *personal* services, almost uniformly held to be nonassignable; it did *not* deal with a contract or an option to buy property, which ordinarily imposes no other obligation on the buyer than to make payment, as does the option now before this court.

[45] Neither personal skill nor personal qualities can be conjured as a requirement for the exercise of the option reserved in the deed here, regardless of how ardent may be the desire of the parties (the bankrupt husband-optionee and his sister), "to keep the property in the … family." Particularly is this true when a contrary holding

would permit the property to be acquired by plaintiff referee in bankruptcy for the benefit of the creditors of the bankrupt husband.

[46] Comment hardly seems necessary on the convenience to a bankrupt of such a device to defeat his creditors. He need only produce parol testimony that any options (or other property, for that matter) which he holds are subject to an oral "collateral agreement" with family members (or with friends) that the property is nontransferable "in order to keep the property in the family" or in the friendly group. In the present case the value of the ranch which the bankrupt and his wife held an option to purchase has doubtless increased substantially during the years since they acquired the option. The initiation of this litigation by the trustee in bankruptcy to establish his right to enforce the option indicates his belief that there is substantial value to be gained for the creditors from this asset of the bankrupt. Yet the majority opinion permits defeat of the trustee and of the creditors through the device of an asserted collateral oral agreement that the option was "personal" to the bankrupt and nonassignable "in order to keep the property in the family"![xvii]

[47] It also seems appropriate to inquire as to the rights of plaintiff wife in the option which she holds with her bankrupt husband. Is her interest therein also subject to being shown to be personal and not salable or assignable? And, what are her rights and those of her husband in the ranch land itself, if they exercise their option to purchase it? Will they be free to then sell the land? Or, if they prefer, may they hold it beyond the reach of creditors? Or can other members of "the family" claim some sort of restriction on it in perpetuity, established by parol evidence?

[48] And if defendants sell the land subject to the option, will the new owners be heard to assert that the option is "personal" to the optionees, "in order to keep the property in the Masterson family"? Or is that claim "personal" to defendants only?

[49] These are only a few of the confusions and inconsistencies which will arise to plague property owners and, incidentally,

attorneys and title companies, who seek to counsel and protect them.

[50] I would hold that the trial court ruled correctly on the proffered parol evidence, and would affirm the judgment.

McComb, J., concurs.

1.2.1 Discussion of Mitchill v. Lath and Masterson v. Sine

In *Mitchill v. Lath*, how does the court decide whether the written agreement was integrated?

If you thought that the oral agreement to tear down the ice house had truly been made, can you think of any policy justification for a rule that nevertheless refuses to enforce that agreement?

What exactly is the basis for the court's ruling, in *Masterson v. Sine*, that proof of the alleged oral agreement is admissible?

Do you think that the parties really made the agreement making the repurchase right non-assignable?

1.2.2 The Use of Merger Clauses

Most commercial parties use a "merger clause" (or "integration clause" or "entire agreement clause") to signal that they intend for a court to construe their written agreement as the final and exclusive statement of their agreement. Some commonly used versions of such a clause include the following:

> This Agreement represents the Parties' entire understanding regarding the subject matter herein. None of the terms of this Agreement can be waived or modified, except by an express agreement signed by the Parties. There are no representations, promises, warranties, covenants, or undertakings between the Parties other than those expressly set forth in this Agreement.
>
> OR

This agreement constitutes the entire agreement between the parties. There are no understandings, agreements, or representations, oral or written, not specified herein regarding this agreement. Contractor, by the signature below of its authorized representative, hereby acknowledges that the Contractor has read this agreement, understands it, and agrees to be bound by its terms and conditions.

OR

This Agreement, along with any exhibits, appendices, addendums, schedules, and amendments hereto, encompasses the entire agreement of the parties, and supersedes all previous understandings and agreements between the parties, whether oral or written. The parties hereby acknowledge and represent, by affixing their hands and seals hereto, that said parties have not relied on any representation, assertion, guarantee, warranty, collateral contract or other assurance, except those set out in this Agreement, made by or on behalf of any other party or any other person or entity whatsoever, prior to the execution of this Agreement. The parties hereby waive all rights and remedies, at law or in equity, arising or which may arise as the result of a party's reliance on such representation, assertion, guarantee, warranty, collateral contract or other assurance, provided that nothing herein contained shall be construed as a restriction or limitation of said party's right to remedies associated with the gross negligence, willful misconduct or fraud of any person or party taking place prior to, or contemporaneously with, the execution of this Agreement.

OR

> This Agreement and the exhibits attached hereto contain the entire agreement of the parties with respect to the subject matter of this Agreement, and supersede all prior negotiations, agreements and understandings with respect thereto. This Agreement may only be amended by a written document duly executed by all parties.

Courts typically enforce merger clauses as a matter of course unless they find evidence of procedural unconscionability. *See, e.g.*, *Brinderson-Newberg Joint Venture v. Pacific Erectors, Inc.*, 971 F.2d 272, 276 (9th Cir. 1992) (enforcing merger clause as bar to parol evidence).

1.2.3 The Restatement Formulation of the Parol Evidence Rule

It should be apparent from reading *Mitchill v. Lath* and *Masterson v. Sine* that there is no consensus among judges or jurisdictions about when to consider evidence of prior or contemporaneous oral agreements. Nevertheless, there is broad agreement about the general doctrinal framework within which these issues are analyzed. Whether textualist or contextualist, jurists all ask first whether the written agreement is partially or completely "integrated" and then whether the proffered additional terms are "consistent" with the writing. The Restatement (Second) of Contracts formulates these rules as follows:

> **§ 209. Integrated Agreements**
>
> (1) An integrated agreement is a writing or writings constituting a final expression of one or more terms of an agreement.
>
> (2) Whether there is an integrated agreement is to be determined by the court as a question preliminary to determination of a question of interpretation or to application of the parol evidence rule.

(3) Where the parties reduce an agreement to a writing which in view of its completeness and specificity reasonably appears to be a complete agreement, it is taken to be an integrated agreement unless it is established by other evidence that the writing did not constitute a final expression.

§ 210. Completely and Partially Integrated Agreements

(1) A completely integrated agreement is an integrated agreement adopted by the parties as a complete and exclusive statement of the terms of the agreement.

(2) A partially integrated agreement is an integrated agreement other than a completely integrated agreement.

(3) Whether an agreement is completely or partially integrated is to be determined by the court as a question preliminary to determination of a question of interpretation or to application of the parol evidence rule.

§ 213. Effect of Integrated Agreement on Prior Agreements (Parol Evidence Rule)

(1) A binding integrated agreement discharges prior agreements to the extent that it is inconsistent with them.

(2) A binding completely integrated agreement discharges prior agreements to the extent that they are within its scope.

(3) An integrated agreement that is not binding or that is voidable and avoided does not discharge a prior agreement. But an integrated agreement, even though not binding, may be effective to render

inoperative a term which would have been part of the agreement if it had not been integrated.

§ 214. Evidence of Prior or Contemporaneous Agreements and Negotiations

Agreements and negotiations prior to or contemporaneous with the adoption of a writing are admissible in evidence to establish

(a) that the writing is or is not an integrated agreement;

(b) that the integrated agreement, if any, is completely or partially integrated;

(c) the meaning of the writing, whether or not integrated;

(d) illegality, fraud, duress, mistake, lack of consideration, or other invalidating cause;

(e) ground for granting or denying rescission, reformation, specific performance, or other remedy.

§ 215. Contradiction of Integrated Terms

Except as stated in the preceding Section, where there is a binding agreement, either completely or partially integrated, evidence of prior or contemporaneous agreements or negotiations is not admissible in evidence to contradict a term of the writing.

§ 216 Consistent Additional Terms

(1) Evidence of a consistent additional term is admissible to supplement an integrated agreement unless the court finds that the agreement was completely integrated.

(2) An agreement is not completely integrated if the writing omits a consistent additional agreed term which is

(a) agreed to for separate consideration, or

(b) such a term as in the circumstances might naturally be omitted from the writing.

2. The UCC Parol Evidence Rule

The same problems of identifying and interpreting contract terms that arise under the common law also affect transactions involving the sale of goods. The Uniform Commercial Code includes a section that, unsurprisingly, embraces a thoroughly contextualist approach to these issues.

§ 2-202 Final Written Expression: Parol or Extrinsic Evidence.

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented

(a) by course of dealing or usage of trade (Section 1-205) or by course of performance (Section 2-208); and

(b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

Official Comment

Purposes:

1. This section definitely rejects:

> (a) Any assumption that because a writing has been worked out which is final on some matters, it is to be taken as including all the matters agreed upon;
>
> (b) The premise that the language used has the meaning attributable to such language by rules of construction existing in the law rather than the meaning which arises out of the commercial context in which it was used; and
>
> (c) The requirement that a condition precedent to the admissibility of the type of evidence specified in paragraph (a) is an original determination by the court that the language used is ambiguous.

2. Paragraph (a) makes admissible evidence of course of dealing, usage of trade and course of performance to explain or supplement the terms of any writing stating the agreement of the parties in order that the true understanding of the parties as to the agreement may be reached. Such writings are to be read on the assumption that the course of prior dealings between the parties and the usages of trade were taken for granted when the document was phrased. Unless carefully negated they have become an element of the meaning of the words used. Similarly, the course of actual performance by the parties is considered the best indication of what they intended the writing to mean.

3. Under paragraph (b) consistent additional terms, not reduced to writing, may be proved unless the court finds that the writing was intended by both parties as a complete and exclusive statement of all the terms. 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.

> The reference in § 2-202 to usage of trade, course of dealing and course of performance evidence requires a bit more explanation. In the following enacted section of the Virginia Commercial Code, which mirrors § 2-208 of the UCC, we see how the statute establishes an interpretive hierarchy among these forms of contextual evidence.

§ 8.1A-303 Course of performance, course of dealing, and usage of trade.

(a) A "course of performance" is a sequence of conduct between the parties to a particular transaction that exists if:

> (1) the agreement of the parties with respect to the transaction involves repeated occasions for performance by a party; and
>
> (2) the other party, with knowledge of the nature of the performance and opportunity for objection to it, accepts the performance or acquiesces in it without objection.

(b) A "course of dealing" is a sequence of conduct concerning previous transactions between the parties to a particular transaction that is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.

(c) A "usage of trade" is 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. The existence and scope of such a usage must be proved as facts. If it is established that such a usage is embodied in a trade code or similar record, the interpretation of the record is a question of law.

(d) A course of performance or course of dealing between the parties or usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware is relevant in ascertaining the meaning of the parties' agreement, may give particular meaning to specific terms of the agreement, and may supplement or qualify the terms of the agreement. A usage of trade applicable in the place in which part of the performance under the agreement is to occur may be so utilized as to that part of the performance.

(e) Except as otherwise provided in subsection (f), the express terms of an agreement and any applicable course of performance, course of dealing, or usage of trade must be construed whenever reasonable as consistent with each other. If such a construction is unreasonable:

> (1) express terms prevail over course of performance, course of dealing, and usage of trade;
>
> (2) course of performance prevails over course of dealing and usage of trade; and
>
> (3) course of dealing prevails over usage of trade.

(f) Subject to § 2-209, a course of performance is relevant to show a waiver or modification of any term inconsistent with the course of performance.

(g) Evidence of a relevant usage of trade offered by one party is not admissible unless that party has given the other party notice that the court finds sufficient to prevent unfair surprise to the other party.

2.1 Principal Case – Hunt Foods & Industries v. Doliner

The following case illustrates the (mis)application of § 2-202 to an alleged oral agreement to limit the circumstances in which an option could be exercised.

Hunt Foods & Industries v. Doliner

Supreme Court of New York, Appellate Division

26 A.D.2d 41, 270 N.Y.S.2d 937, *aff'd*, 272 N.Y.S.2d 686 (1966)

STEUER, J.

[1] In February, 1965 plaintiff corporation undertook negotiations to acquire the assets of Eastern Can Company. The stock of the latter is owned by defendant George M. Doliner and his family to the extent of 73%. The balance is owned by independent interests. At a fairly early stage of the negotiations agreement was reached as to the price to be paid by plaintiff ($5,922,500 if in cash, or $5,730,000 in Hunt stock), but several important items, including the form of the acquisition, were not agreed upon. At this point it was found necessary to recess the negotiations for several weeks. The Hunt negotiators expressed concern over any adjournment and stated that they feared that Doliner would use their offer as a basis for soliciting a higher bid from a third party. To protect themselves they demanded an option to purchase the Doliner stock. Such an option was prepared and signed by George Doliner and the members of his family and at least one other person associated with him who were stockholders. It provides that Hunt has the option to buy all of the Doliner stock at $5.50 per share. The option is to be exercised by giving notice on or before June 1, 1965, and if notice is not given the option is void. If given, Hunt is to pay the price and the Doliners to deliver their stock within seven days thereafter. The agreement calls for Hunt to pay $1,000 for the option, which was paid. To this point there is substantial accord as to what took place.

[2] Defendant claims that when his counsel called attention to the fact that the option was unconditional in its terms, he obtained an understanding that it was only to be used in the event that he solicited an outside offer; and that plaintiff insisted that unless the option was signed in unconditional form negotiations would terminate. Plaintiff contends there

was no condition. Concededly, on resumption of negotiations the parties failed to reach agreement and the option was exercised. Defendants declined the tender and refused to deliver the stock.

[3] Plaintiff moved for summary judgment for specific performance. We do not believe that summary judgment lies. Plaintiff's position is that the condition claimed could not be proved under the parol evidence rule and, eliminating that, there is no defense to the action.

[4] The parol evidence rule, at least as that term refers to contracts of sale,[xviii] is now contained in section 2-202 of the Uniform Commercial Code, which reads:

> Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented …
>
> (b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

[5] The term (that the option was not to be exercised unless Doliner sought outside bids), admittedly discussed but whose operative effect is disputed, not being set out in the writing, is clearly "additional" to what is in the writing. So the first question presented is whether that term is "consistent" with the instrument. In a sense any oral provision which would prevent the ripening of the obligations of a writing is inconsistent with the writing. But that obviously is not the sense in which the word is used (*Hicks v. Bush*, 10 N Y 2d 488, 491). To be inconsistent the term must contradict or

negate a term of the writing. A term or condition which has a lesser effect is provable.

[6] The Official Comment prepared by the drafters of the code contains this statement: "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." (McKinney's Uniform Commercial Code, Part 1, p. 158.)

[7] Special Term interpreted this language as not only calling for an adjudication by the court in all instances where proof of an "additional oral term" is offered, but making that determination exclusively the function of the court. We believe the proffered evidence to be inadmissible only where the writing contradicts the existence of the claimed additional term (*Meadow Brook Nat. Bank v. Bzura*, 20 A D 2d 287, 290). The conversations in this case, some of which are not disputed, and the expectation of all the parties for further negotiations, suggest that the alleged oral condition precedent cannot be precluded as a matter of law or as factually impossible. It is not sufficient that the existence of the condition is implausible. It must be impossible (cf. *Millerton Agway Co-op. v. Briarcliff Farms*, 17 N Y 2d 57, 63-64).

[8] The order should be reversed on the law and the motion for summary judgment denied, with costs and disbursements to abide the event.

2.1.1 Snyder v. Herbert Greenbaum & Associates

In *Hunt Foods*, the court construed the requirement in UCC § 2-202(b) that any proffered additional terms must be "consistent" to preclude only proof of terms that contradict or negate the written agreement. Other courts have explicitly rejected this interpretation of the statute.

In *Snyder v. Herbert Greenbaum & Associates*, 38 Md. App. 144, 380 A.2d 618 (1977), a contractor agreed to supply and install carpet and padding for 228 garden apartments that a developer was about to build. The developer chose to cancel the contract after discovering that it had ordered about ten percent more carpet than would be needed for the apartments. When the contractor sued for breach, the developer sought to introduce evidence that five prior contracts between the parties had been rescinded by mutual agreement. According to the developer, this evidence established a course of dealing or oral agreement giving either party a unilateral right to modify or cancel any contract between them.

The court of appeals upheld the trial court's decision to reject the developer's argument and award damages to the contractor. The court noted that a course of dealing can be used to give meaning to the terms of a written contract, but the purported cancellation privilege was an additional term that should be analyzed under UCC § 2-202(b). Applying the test of Comment 3, the court held that such a term "would certainly have been included" in the writing and thus the developer should be barred from relying on that evidence. Finally the court expressed its disagreement with the analysis of consistency in *Hunt Foods*:

> At any rate, for much the same reason, we hold that the additional terms offered by appellants are inconsistent with the contract itself. In so doing we reject the narrow view of inconsistency espoused in Hunt Foods v. Doliner, 26 A.D.2d 41, 270 N.Y.S.2d 937 (1966), and Schiavone and Sons v. Securalloy Co., 312 F. Supp. 801 (D. Conn. 1970). Those cases hold that to be inconsistent the "additional terms" must negate or contradict express terms of the agreement.
>
> This interpretation of "inconsistent" is itself inconsistent with a reading of the whole of § 2-202. Direct contradiction of express terms is forbidden in the initial paragraph of § 2-202. The *Hunt Foods* interpretation renders that passage a nullity, a result which is to be avoided. Gillespie v. R & J Constr. Co., 275 Md. 454 (1975).

> Rather we believe "inconsistency" as used in § 2-202(b) means the absence of reasonable harmony in terms of the language and respective obligations of the parties. § 1-205(4); see Southern Concrete Services v. Mableton Contractors, 407 F. Supp. 581 (N.D. Ga. 1975). In terms of the obligations of the appellee, which required appellee to make extensive preparations in order to perform [such as purchasing substantial quantities of materials in anticipation of the project], unqualified unilateral cancellation by appellants is not reasonably harmonious. Therefore, evidence of the additional terms was properly excluded by the trial judge, and we find no error.

Id. at 152.

2.1.2 Discussion of Hunt Foods v. Doliner

What is the court's holding and reasoning concerning the alleged agreement to limit the circumstances in which Hunt Foods would be entitled to exercise its option to purchase the Eastern Can stock?

Do you agree with the court's interpretation of § 2-202?

Is there any reason to worry that the court's approach might defeat the purpose for which the parties executed the option?

How would the approach taken in *Snyder* apply to the facts of *Hunt Foods*?

3 Interpretation

Although we have focused on the rules that determine which terms become part of a contract, there is also an analogous group of doctrines governing the interpretation of those terms. These interpretive rules confront the same tension that exists between formal textualist and permissive contextualist approaches to parol evidence.

On the side of formalism, we find the so-called "plain meaning" school of interpretation. Loosely speaking, judges committed to this approach ask first whether the terms of the written contract are ambiguous and only permit parties to introduce extrinsic evidence if the language in question appears reasonably susceptible to alternative interpretations. Adherents to the formalist school view the ordinary dictionary definition of express contract terms as an important constraint on the range of potential interpretations. They are likely to be skeptical about a party's self-serving attempts to evade the conventional meaning of a word by alleging idiosyncratic exceptions or variant meanings.

The currently ascendant contextualist approach to interpretation focuses instead on a (possibly quixotic) quest to discover the true meaning that the parties have attached to the relevant terms. Courts committed to this interpretive perspective are inclined to consider any contextual evidence that might plausibly reveal something about the parties' intentions. The Uniform Commercial Code § 2-202(a) embodies this permissive evidentiary standard by allowing a course of dealing, a usage of trade, or a course of performance to "explain" the meaning of any contract term.

VII. Remedies for Breach

If the parties have formed an enforceable contract and no grounds exist to excuse performance, then a promisor who fails to perform breaches a contractual obligation. Recall that Restatement (Second) § 1 defined a contract as "a promise or a set of promises for the breach of which the law gives a remedy…." We turn our attention now to learning something about what "remedy" the law gives for breach of contract. In *Lucy v. Zehmer*, the court ordered the Zehmers to perform their promise to convey the Ferguson farm to Lucy in exchange for $50,000. As we will see, this remedy of "specific performance" is available most often in contracts for the sale of real estate or other unique goods (such as antiques and artwork), but it is not the norm and requires special justification. Courts instead prefer the remedy of money damages for breach.

The cases that follow thus begin with an introduction to the law of damages. We investigate several possible policy justifications for protecting a promisee's "expectation interest" in the event of breach. Next, we examine the doctrinal requirements for awarding specific performance and consider the argument of some academics that specific performance should perhaps be the rule rather than the exception. Turning our attention to limitations on damages, we study the venerable foreseeability doctrine, learn how the certainty limitation affects recovery of lost profits from a new business, and discover why avoidability/mitigation doctrine may confront a promisee with difficult choices. We also ask whether awarding the cost of performance or the value of performance best compensates for the loss that a promisee suffers from contract breach. We conclude with the surprisingly stringent rules restricting the use of liquidated damages.

1 Monetary Damages

1.1 Introduction

The usual remedy for contract breach is "expectation" damages. The following sections of the Restatement (Second) describe the damage remedy and its principal limitations:

§ 344. Purposes of Remedies

Judicial remedies under the rules stated in this Restatement serve to protect one or more of the following interests of a promisee:

> (a) his "expectation interest," which is his interest in having the benefit of his bargain by being put in as good a position as he would have been in had the contract been performed,
>
> (b) his "reliance interest," which is his interest in being reimbursed for loss caused by reliance on the contract by being put in as good a position as he would have been in had the contract not been made, or
>
> (c) his "restitution interest," which is his interest in having restored to him any benefit that he has conferred on the other party.

§ 346. Availability of Damages

(1) The injured party has a right to damages for any breach by a party against whom the contract is enforceable unless the claim for damages has been suspended or discharged.

(2) If the breach caused no loss or if the amount of the loss is not proved under the rules stated in this Chapter, a small sum fixed without regard to the amount of the loss will be awarded as nominal damages.

§ 347. Measure of Damages in General

Subject to the limitations stated in §§ 350-53, the injured party has a right to damages based on his expectation interest as measured by

(a) the loss in the value to him of the other party's performance caused by its failure or deficiency, plus

(b) any other loss, including incidental or consequential loss, caused by the breach, less

(c) any cost or other loss that he has avoided by not having to perform.

§ 350. Avoidability as a Limitation on Damages

(1) Except as stated in Subsection (2), damages are not recoverable for loss that the injured party could have avoided without undue risk, burden or humiliation.

(2) The injured party is not precluded from recovery by the rule stated in Subsection (1) to the extent that he has made reasonable but unsuccessful efforts to avoid loss.

§ 351. Unforeseeability and Related Limitations on Damages

(1) Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made.

(2) Loss may be foreseeable as a probable result of a breach because it follows from the breach

(a) in the ordinary course of events, or

(b) as a result of special circumstances, beyond the ordinary course of events, that the party in breach had reason to know.

(3) A court may limit damages for foreseeable loss by excluding recovery for loss of profits, by allowing recovery only for loss incurred in reliance, or

otherwise if it concludes that in the circumstances justice so requires in order to avoid disproportionate compensation.

§ 352. Uncertainty as a Limitation on Damages

Damages are not recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty.

§ 353. Loss Due to Emotional Disturbance

Recovery for emotional disturbance will be excluded unless the breach also caused bodily harm or the contract or the breach is of such a kind that serious emotional disturbance is a particularly likely result.

In contracts for the sale of goods, the Uniform Commercial Code supplies additional guidance about remedies. The provisions for buyer's remedies include the following sections:

§ 2-711. Buyer's Remedies in General

(1) Where the seller fails to make delivery or repudiates or the buyer rightfully rejects or justifiably revokes acceptance then with respect to any goods involved, and with respect to the whole if the breach goes to the whole contract (Section 2-612), the buyer may cancel and whether or not he has done so may in addition to recovering so much of the price as has been paid

(a) "cover" and have damages under the next section as to all the goods affected whether or not they have been identified to the contract; or

(b) recover damages for non-delivery as provided in this Article (Section 2-713).

(2) Where the seller fails to deliver or repudiates the buyer may also

> (a) if the goods have been identified recover them as provided in this Article (Section 2-502); or
>
> (b) in a proper case obtain specific performance or replevy the goods as provided in this Article (Section 2-716).

§ 2-712. "Cover"; Buyer's Procurement of Substitute Goods

(1) After a breach within the preceding section the buyer may "cover" by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller.

(2) The buyer may recover from the seller as damages the difference between the cost of cover and the contract price together with any incidental or consequential damages as hereinafter defined (Section 2-715), but less expenses saved in consequence of the seller's breach.

(3) Failure of the buyer to effect cover within this section does not bar him from any other remedy.

§ 2-713. Buyer's Damages for Non-Delivery or Repudiation

(1) Subject to the provisions of this Article with respect to proof of market price (Section 2-723), the measure of damages for non-delivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages provided in this Article

(Section 2-715), but less expenses saved in consequence of the seller's breach.

(2) Market price is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

§ 2-715. Buyer's Incidental and Consequential Damages

(1) Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.

(2) Consequential damages resulting from the seller's breach include

> (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and
>
> (b) injury to person or property proximately resulting from any breach of warranty.

1.1.1 Globe Refining Co. v. Landa Cotton Oil Co.

In *Globe Refining Co. v. Landa Cotton Oil Co.*, 190 U.S. 540 (1903), a Texas supplier made a contract to deliver ten railroad tanker cars of prime crude oil "f.o.b. buyers' tanks at [sellers'] mill." When the sellers repudiated the deal shortly before the time for delivery, the Kentucky buyers sued, seeking compensation for the cost of sending their tanker cars to Texas. They also sought to recover for the loss of use of the cars and for damages suffered when the lack of oil forced the buyers to breach contracts with their own customers. Justice

Oliver Wendell Holmes affirmed the trial court's ruling that the proper damage measure in this case was "the difference between the contract price of the oil and the price at the time of the breach." He explained the underlying principles of contract damages in the following terms:

> When a man commits a tort, he incurs, by force of the law, a liability to damages, measured by certain rules. When a man makes a contract, he incurs, by force of the law, a liability to damages, unless a certain promised event comes to pass. But, unlike the case of torts, as the contract is by mutual consent, the parties themselves, expressly or by implication, fix the rule by which the damages are to be measured. The old law seems to have regarded it as technically in the election of the promisor to perform or to pay damages. *Bromage* v. *Genning*, 1 Rolle, 368; *Hulbert* v. *Hart*, 1 Vern. 133. It is true that, as people when contracting contemplate performance, not breach, they commonly say little or nothing as to what shall happen in the latter event, and the common rules have been worked out by common sense, which has established what the parties probably would have said if they had spoken about the matter. But a man never can be absolutely certain of performing any contract when the time of performance arrives, and, in many cases, he obviously is taking the risk of an event which is wholly, or to an appreciable extent, beyond his control. The extent of liability in such cases is likely to be within his contemplation, and, whether it is or not, should be worked out on terms which it fairly may be presumed he would have assented to if they had been presented to his mind. For instance, in the present case, the defendant's mill and all its oil might have been burned before the time came

for delivery. Such a misfortune would not have been an excuse, although probably it would have prevented performance of the contract. If a contract is broken, the measure of damages generally is the same, whatever the cause of the breach. We have to consider, therefore, what the plaintiff would have been entitled to recover in that case, and that depends on what liability the defendant fairly may be supposed to have assumed consciously, or to have warranted the plaintiff reasonably to suppose that it assumed, when the contract was made.

…

It may be said with safety that mere notice to a seller of some interest or probable action of the buyer is not enough necessarily and as a matter of law to charge the seller with special damage on that account if he fails to deliver the goods. With that established, we recur to the allegations. With regard to the first, it is obvious that the plaintiff was free to bring its tanks from where it liked -- a thousand miles away or an adjoining yard -- so far as the contract was concerned. The allegation hardly amounts to saying that the defendant had notice that the plaintiff was likely to send its cars from a distance. It is not alleged that the defendant had notice that the plaintiff had to bind itself to pay nine hundred dollars, at the time when the contract was made, and it nowhere is alleged that the defendant assumed any liability in respect of this uncertain element of charge. The same observations may be made with regard to the claim for loss of use of the tanks and to the final allegations as to sending the tanks from distant points. It is true that this last was alleged to have been in contemplation of the

> contract, if we give the plaintiff the benefit of the doubt in construing a somewhat confused sentence. But, having the contract before us, we can see that this ambiguous expression cannot be taken to mean more than notice, and notice of a fact which would depend upon the accidents of the future.
>
> It is to be said further with regard to the foregoing items that they were the expenses which the plaintiff was willing to incur for performance. If it had received the oil, these were deductions from any profit which the plaintiff would have made. But if it gets the difference between the contract price and the market price, it gets what represents the value of the oil in its hands, and to allow these items in addition would be making the defendant pay twice for the same thing.

1.1.2 Hypo Based on *Globe Refining*

As an exercise to test your understanding of the basic rules of contract damages, consider the following hypothetical, which is based loosely on the facts of *Globe Refining*:

> Plaintiff contracts to buy 10 tanker trucks full of fuel oil at $10,000 per truckload. The defendant seller is in Louisville, Kentucky, and plaintiff buyer is in New Braunfels, Texas. The buyer sends a $4,000 deposit check. On the agreed delivery date, the buyer sends ten empty tank trucks from Texas to Louisville at a total cost of $1,600. But the seller has already sold the oil to a New York buyer for $14,000 per truckload.
>
> Oil is available in Indianapolis for $12,000 per truckload but it is not available in Louisville. Plaintiff buyer could send trucks to Indianapolis for a total cost of $700. But instead he sends them back to Texas empty. As a result, plaintiff breaches several contracts

> with customers in Texas. These breaches cost $54,000. Some customers announce that they will no longer do business with plaintiff. Finally, the plaintiff suffers a serious nervous breakdown and pays $1,000 for treatment. Plaintiff sues in Texas state court. His attorney's fees are $20,000. It takes two years for the case to come to trial.

For each of the buyer's possible losses, determine whether or not it would be compensable under an expectation measure of damages.

1.1.3 Discussion of Hypo Based on *Globe Refining*

Many, perhaps most, contracts omit any mention of remedies and do not provide expressly for a measure of damages. In view of this frequent omission, what does Justice Holmes suggest that courts should do?

How do the provisions of the Restatement and the UCC apply to the hypothetical? To what would the buyer ordinarily be entitled?

Is there any need to award the buyer specific performance of this promise?

1.2 Principal Case – Freund v. Washington Square Press

As you read the following case, try to identify the losses that could form part of Freund's expectation interest. Think carefully about why he ends up with just six cents and consider whether you find the court's reasoning convincing.

Freund v. Washington Square Press, Inc.
Court of Appeals of New York
314 N.E.2d 419, 357 N.Y.S.2d 857 (1974)

RABIN, JUDGE.

[1] In this action for breach of a publishing contract, we must decide what damages are recoverable for defendant's failure to publish plaintiff's manuscript. In 1965, plaintiff, an author and a college teacher, and defendant, Washington Square Press, Inc., entered into a written agreement which, in relevant part, provided as follows. Plaintiff ("author") granted

defendant ("publisher") exclusive rights to publish and sell in book form plaintiff's work on modern drama. Upon plaintiff's delivery of the manuscript, defendant agreed to complete payment of a nonreturnable $2,000 "advance." Thereafter, if defendant deemed the manuscript not "suitable for publication," it had the right to terminate the agreement by written notice within 60 days of delivery. Unless so terminated, defendant agreed to publish the work in hardbound edition within 18 months and afterwards in paperbound edition. The contract further provided that defendant would pay royalties to plaintiff, based upon specified percentages of sales. (For example, plaintiff was to receive 10% of the retail price of the first 10,000 copies sold in the continental United States.) If defendant failed to publish within 18 months, the contract provided that "this agreement shall terminate and the rights herein granted to the Publisher shall revert to the Author. In such event all payments therefore made to the Author shall belong to the Author without prejudice to any other remedies which the Author may have." The contract also provided that controversies were to be determined pursuant to the New York simplified procedure for court determination of disputes (CPLR 3031-3037, Consol. Laws, c. 8).

[2] Plaintiff performed by delivering his manuscript to defendant and was paid his $2,000 advance. Defendant thereafter merged with another publisher and ceased publishing in hardbound. Although defendant did not exercise its 60-day right to terminate, it has refused to publish the manuscript in any form.

[3] Plaintiff commenced the instant action pursuant to the simplified procedure practice and initially sought specific performance of the contract. The Trial Term Justice denied specific performance but, finding a valid contract and a breach by defendant, set the matter down for trial on the issue of monetary damages, if any, sustained by the plaintiff. At trial, plaintiff sought to prove: (1) delay of his academic

promotion; (2) loss of royalties which would have been earned; and (3) the cost of publication if plaintiff had made his own arrangements to publish. The trial court found that plaintiff had been promoted despite defendant's failure to publish, and that there was no evidence that the breach had caused any delay. Recovery of lost royalties was denied without discussion. The court found, however, that the loss of hardcover publication to plaintiff was the natural and probable consequence of the breach and, based upon expert testimony, awarded $10,000 to cover this cost. It denied recovery of the expenses of paperbound publication on the ground that plaintiff's proof was conjectural.

[4] The Appellate Division, (3 to 2) affirmed, finding that the cost of publication was the proper measure of damages. In support of its conclusion, the majority analogized to the construction contract situation where the cost of completion may be the proper measure of damages for a builder's failure to complete a house or for use of wrong materials. The dissent concluded that the cost of publication is not an appropriate measure of damages and consequently, that plaintiff may recover nominal damages only.[xix] We agree with the dissent. In so concluding, we look to the basic purpose of damage recovery and the nature and effect of the parties' contract.

[5] It is axiomatic that, except where punitive damages are allowable, the law awards damages for breach of contract to compensate for injury caused by the breach—injury which was foreseeable, i.e., reasonably within the contemplation of the parties, at the time the contract was entered into. (*Swain v. Schieffelin*, 134 N.Y. 471, 473, 31 N.E. 1025, 1026.) Money damages are substitutional relief designed in theory "to put the injured party in as good a position as he would have been put by full performance of the contract, at the least cost to the defendant and without charging him with harms that he had no sufficient reason to foresee when he made the contract." (5 CORBIN, CONTRACTS, § 1002, pp. 31-32; 11

WILLISTON, CONTRACTS (3d ed.), § 1338, p. 198.) In other words, so far as possible, the law attempts to secure to the injured party the benefit of his bargain, subject to the limitations that the injury—whether it be losses suffered or gains prevented—was foreseeable, and that the amount of damages claimed be measurable with a reasonable degree of certainty and, of course, adequately proven. (See, generally, DOBBS, LAW OF REMEDIES, p. 148; see, also, Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145, 1159 [(1970)].) But it is equally fundamental that the injured party should not recover more from the breach than he would have gained had the contract been fully performed. (*Baker v. Drake*, 53 N.Y. 211, 217; see, generally, DOBBS, LAW OF REMEDIES, p. 810.)

[6] Measurement of damages in this case according to the cost of publication to the plaintiff would confer greater advantage than performance of the contract would have entailed to plaintiff and would place him in a far better position than he would have occupied had the defendant fully performed. Such measurement bears no relation to compensation for plaintiff's actual loss or anticipated profit. Far beyond compensating plaintiff for the interests he had in the defendant's performance of the contract—whether restitution, reliance or expectation (see Fuller & Perdue, *Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 53-56 [(1936)]) an award of the cost of publication would enrich plaintiff at defendant's expense.

[7] Pursuant to the contract, plaintiff delivered his manuscript to the defendant. In doing so, he conferred a value on the defendant which, upon defendant's breach, was required to be restored to him. Special Term, in addition to ordering a trial on the issue of damages, ordered defendant to return the manuscript to plaintiff and plaintiff's restitution interest in the contract was thereby protected. (Cf. 5 CORBIN, CONTRACTS, § 996, p. 15.)

[8] At the trial on the issue of damages, plaintiff alleged no reliance losses suffered in performing the contract or in making necessary preparations to perform. Had such losses, if foreseeable and ascertainable, been incurred, plaintiff would have been entitled to compensation for them. (*Cf. Bernstein v. Meech*, 130 N.Y. 354, 359, 29 N.E. 255, 257.)

[9] As for plaintiff's expectation interest in the contract, it was basically two-fold—the "advance" and the royalties. (To be sure, plaintiff may have expected to enjoy whatever notoriety, prestige or other benefits that might have attended publication, but even if these expectations were compensable, plaintiff did not attempt at trial to place a monetary value on them.) There is no dispute that plaintiff's expectancy in the "advance" was fulfilled—he has received his $2,000. His expectancy interest in the royalities—the profit he stood to gain from sale of the published book—while theoretically compensable, was speculative. Although this work is not plaintiff's first, at trial he provided no stable foundation for a reasonable estimate of royalties he would have earned had defendant not breached its promise to publish. In these circumstances, his claim for royalties falls for uncertainty. (Cf. *Broadway Photoplay Co. v. World Film Corp.*, 225 N.Y. 104, 121 N.E. 756; *Hewlett v. Caplin*, 275 App. Div. 797, 88 N.Y.S.2d 428.)

[10]Since the damages which would have compensated plaintiff for anticipated royalties were not proved with the required certainty, we agree with the dissent in the Appellate Division that nominal damages alone are recoverable. (Cf. *Manhattan Sav. Inst. v. Gottfried Baking Co.*, 286 N.Y. 398, 36 N.E.2d 637.) Though these are damages in name only and not at all compensatory, they are nevertheless awarded as a formal vindication of plaintiff's legal right to compensation which has not been given a sufficiently certain monetary valuation. (Cf. *Baker v. Hart*, 123 N.Y. 470, 474, 25 N.E. 948, 949; see, generally, DOBBS, LAW OF REMEDIES, p. 191; 11 WILLISTON, CONTRACTS (3d ed.), § 1339A, pp. 206-208.)

[11]In our view, the analogy by the majority in the Appellate Division to the construction contract situation was inapposite. In the typical construction contract, the owner agrees to pay money or other consideration to a builder and expects, under the contract, to receive a completed building in return. The value of the promised performance to the owner is the properly constructed building. In this case, unlike the typical construction contract, the value to plaintiff of the promised performance—publication—was a percentage of sales of the books published and not the books themselves. Had the plaintiff contracted for the printing, binding and delivery of a number of hardbound copies of his manuscript, to be sold or disposed of as he wished, then perhaps the construction analogy, and measurement of damages by the cost of replacement or completion, would have some application.

[12]Here, however, the specific value to plaintiff of the promised publication was the royalties he stood to receive from defendant's sales of the published book. Essentially, publication represented what it would have cost the defendant to confer that value upon the plaintiff, and, by its breach, defendant saved that cost. The error by the courts below was in measuring damages not by the value to plaintiff of the promised performance but by the cost of that performance to defendant. Damages are not measured, however, by what the defaulting party saved by the breach, but by the natural and probable consequences of the breach to the plaintiff. In this case, the consequence to plaintiff of defendant's failure to publish is that he is prevented from realizing the gains promised by the contract—the royalties. But, as we have stated, the amount of royalties plaintiff would have realized was not ascertained with adequate certainty and, as a consequence, plaintiff may recover nominal damages only.

[13]Accordingly, the order of the Appellate Division should be modified to the extent of reducing the damage award of

> $10,000 for the cost of publication to six cents, but with costs and disbursements to the plaintiff.

1.2.1 Discussion of Freund v. Washington Square Press

So what exactly are Freund's restitution, reliance and expectation interests in this contract?

What evidence could he have offered in an attempt to prove losses in each of these categories?

Why does Freund receive no recovery of royalties?

Does this rule strike you as fair?

1.3 The "Coase Theorem" and Efficient Breach

1.3.1 Efficient Breach

Why do you suppose that courts choose expectation damages rather than a reliance measure, or punitive damages, or even the death penalty for breach? Scholars have offered many arguments to defend the expectation measure. Judge, formerly professor, Richard Posner has written:

> It makes a difference in deciding which remedy to grant whether the breach was opportunistic. If a promisor breaks his promise merely to take advantage of the vulnerability of the promisee in a setting (the normal contract setting) when performance is sequential rather than simultaneous, we might as well throw the book at the promisor….
>
> Most breaches of contract, however, are not opportunistic. Many are involuntary; performance is impossible at a reasonable cost. Others are voluntary but (as we are about to see) efficient—which from an economic standpoint is the same case as that of an involuntary breach. These observations both explain the centrality of remedies to the law of contracts (can you see why?) and give point to Holmes's dictum that it is not the policy of the law to compel adherence to

contracts but only to require each party to choose between performing in accordance with the contract and compensating the other party for any injury resulting from a failure to perform.[xx]

This dictum, though over broad, contains an important economic insight. In many cases it is uneconomical to induce completion of performance of a contract after it has been broken. I agree to purchase 100,000 widgets custom-ground for use as components in a machine that I manufacture. After I have taken delivery of 10,000, the market for my machine collapses. I promptly notify my supplier that I am terminating the contract, and admit that my termination is a breach. When notified of the termination he has not begun the custom grinding of the other 90,000 widgets, but he informs me that he intends to complete his performance under the contract and bill me accordingly. The custom-ground widgets have no operating use other than in my machine, and a negligible scrap value. To give the supplier a remedy that induced him to complete the contract after the breach would waste resources. The law is alert to this danger and, under the doctrine of mitigation of damages, would not give the supplier damages for any costs he incurred in continuing production after notice of termination.

In [this example] the breach was committed only to avert a larger loss, but in some cases a party is tempted to break his contract simply because his profit from breach would exceed his profit from completion of the contract. If it would also exceed the expected profit of the other party from completion of the contract, and if damages are limited to the loss of that

> profit, there will be an incentive to commit a breach. But there should be. Suppose I sign a contract to deliver 100,000 custom-ground widgets at 10 cents apiece to A for use in this boiler factory. After I have delivered 10,000, B comes to me, explains that he desperately needs 25,000 custom-ground widgets at once since otherwise he will be forced to close his pianola factory at great cost, and offers me 15 cents apiece for them. I sell him the widgets and as a result do not complete timely delivery to A, causing him to lose $1,000 in profits. Having obtained an additional profit of $1,250 on the sale to B, I am better off even after reimbursing A for his loss, and B is also better off. The breach is Pareto superior. True, if I had refused to sell to B, he could have gone to A and negotiated an assignment to him of part of A's contract with me. But this would have introduced an additional step, with additional transaction costs—and high ones, because it would be a bilateral-monopoly negotiation. On the other hand, litigation costs would be reduced.

Richard A. Posner, Economic Analysis of Law (2007)

Posner's argument presents one version of the "theory of efficient breach." We will discuss his analysis in detail, but you may wish to consider what assumptions about the parties are necessary to ensure that the breach in Posner's second example will be "efficient." Also give some thought to how parties might react if the damage rule instead required B to compensate A by paying him twice (or ten times or one-half) of his loss.

1.3.2 Discussion of Efficient Breach

In order to better understand the theory of efficient breach, it is helpful to work through a modified version of Posner's second example.

Imagine that a seller (S) signs a contract with a buyer (B) to deliver 10,000 widgets for $1/each (to be used in boiler factory). Before S makes any deliveries, a foreign consortium (FC) offers to pay $2/each for as many widgets as S can produce and deliver within one month. S directs all of its production for 30 days to serving FC. Suppose that S can produce 7,000 widgets in that time. The delay in delivery will cause B to lose $1,000 in profits (e.g., B can't run boiler production at full capacity).

First, try to account for the potential gains and losses in this situation. Then ask yourself what Posner argues that S should do and why?

Now consider whether there are any opportunities for the parties to renegotiate their bargain once a new opportunity arises? How would you expect those negotiations to proceed?

If the parties expect that the default damage rule (e.g., one-half or twenty-times compensatory damages) will frustrate their objectives, what would you advise them to do before signing a contract?

1.3.3 Hypo of Dan and Lynn on the River

(inspired by a hypo from an early edition of the Scott & Leslie, Contract Law & Theory casebook)

Dan sits on his porch overlooking a scenic river. Lynn runs a factory upstream from Dan's house.

Lynn wants to dump waste in the river that is non-toxic but causes a terrible smell that dissipates only after passing Dan's house.

(1) Suppose first that the law gives Dan the legal right to prevent the dumping. (Perhaps it calls the dumping a nuisance.)

> (a) If Lynn values dumping more than Dan values pleasant smelling air, what will the parties do?
>
> (b) If Dan values sweet air more than Lynn values dumping, what will happen now?

(2) Next, change the assignment of legal rights so that Lynn has the right to dump.

(a) If Lynn values dumping more than Dan values pleasant smelling air, what will happen?

(b) If Dan values sweet air more than Lynn values dumping, what will the parties do now?

How does the assignment of the legal right to dump (or prevent dumping) affect the distribution of wealth between Dan and Lynn?

1.3.4 Problem: Signing Bonus for First-Year Associates

Suppose that newly enacted legislation declares the following:

> All legal employers must pay starting first-year associates a signing bonus of $100,000 unless otherwise specified in a written contract of employment.

What do you expect to happen after the effective date of the legislation? Does the enactment of this legislation make first-year associates better off?

Now suppose that the legislation mandates payment of the bonus and prohibits parties from contracting around the bonus requirement. What do you expect to happen in the market for the services of first-year associates? Can you imagine any strategies firms might adopt to diminish the effect of the new law on their labor costs?

2 Specific Performance

As we saw in *Lucy v. Zehmer*, one way to ensure that the promisee (Lucy) receives precisely what he wanted from the contract is to order the promisors (the Zehmers) to perform by conveying title to the Ferguson farm. Although courts routinely order "specific performance" of real estate sales contracts, they also grant specific performance in appropriate circumstances to remedy the breach of a contract for the sale of goods.

Let's begin by reading the relevant section of the UCC.

§ 2-716. Buyer's Right to Specific Performance or Replevin

(1) Specific performance may be decreed where the goods are unique or in other proper circumstances.

(2) The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just.

Official Comment

1. The present section continues in general prior policy as to specific performance and injunction against breach. However, without intending to impair in any way the exercise of the court's sound discretion in the matter, this Article seeks to further a more liberal attitude than some courts have shown in connection with the specific performance of contracts of sale.

2. In view of this Article's emphasis on the commercial feasibility of replacement, a new concept of what are "unique" goods is introduced under this section. Specific performance is no longer limited to goods which are already specific or ascertained at the time of contracting. The test of uniqueness under this section must be made in terms of the total situation which characterizes the contract. Output and requirements contracts involving a particular or peculiarly available source or market present today the typical specific performance situation, as contrasted with contracts for sale of heirlooms or priceless works of art which were usually involved in the older cases. However, uniqueness is not the sole basis of the remedy under this section for the relief may also be granted "in other proper circumstances" and inability to cover is strong evidence of "other proper circumstances".

Why do you suppose that specific performance is only a buyer's remedy under the Uniform Commercial Code? Is there any reason that the seller should not be able to force the buyer to specifically perform the contract?

2.1 Principal Case – *Klein v. Pepsico*

You may not have previously thought of jet airplanes as falling within the definition of "goods" but the following case applies the UCC rules for specific performance to a contract for the sale of a Gulfstream G-II corporate jet. Try to identify precisely what it is about the circumstances surrounding this transaction that made specific performance an inappropriate remedy for PepsiCo's breach.

Klein v. Pepsico, Inc.

United States Court of Appeals, Fourth Circuit

845 F.2d 76 (1988)

ERVIN, CIRCUIT JUDGE:

[1] This case turns on whether a contract was formed between Universal Jet Sales, Inc. ("UJS") and PepsiCo, Inc., ("PepsiCo") for the sale of a Gulfstream G-II corporate jet to UJS for resale to one Eugene V. Klein. If a contract was formed, the question remains whether the district court acted within his discretion by ordering specific performance of the contract. We believe the district court properly found that a contract was formed; however, we conclude that the remedy of specific performance is inappropriate. Accordingly, we affirm in part, reverse and remand in part.

I.

[2] In March 1986, Klein began looking for a used corporate jet; specifically, he wanted a G-II. He contacted Patrick Janas, President of UJS, who provided information to Klein about several aircraft including the PepsiCo aircraft. Klein's pilot and mechanic, Mr. Sherman and Mr. Quaid, inspected the PepsiCo jet in New York. Mr. James Welsch served as the jet broker for PepsiCo.

[3] Klein asked that the jet be flown to Arkansas for his personal inspection. On March 29, 1986, he inspected the jet. Mr. Rashid, PepsiCo Vice President for Asset Management and Corporate Service, accompanied the jet to Arkansas and met Mr. Klein. Janas also went to Arkansas. Klein gave Janas $200,000 as a deposit on the jet, and told Janas to offer $4.4 million for the aircraft.

[4] On March 31, 1986, Janas telexed the $4.4 million offer to Welsch. The telex said the offer was subject to a factory inspection satisfactory to the purchaser, and a definitive contract. On April 1, PepsiCo counteroffered with a $4.7 million asking price. After some dickering, Welsch offered the

jet for $4.6 million. Janas accepted the offer by telex on April 3. Janas then planned to sell the aircraft to Klein for $4.75 million. In Finding of Fact number 18, JA 85, Judge Williams declared that a contract had been formed at this point.

[5] Judge Williams ruled that a contract was evidenced by Janas' confirming telex which "accepted" PepsiCo's offer to sell the jet, and noted that a $100,000 down payment would be wired. The telex also asked for the proper name of the company selling the aircraft. See JA 86 Finding of Fact number 22.

[6] On April 3, Janas sent out copies of the Klein/UJS agreement and the UJS-PepsiCo agreement to the respective parties. Janas also sent a bill of sale to PepsiCo (to Rashid). PepsiCo sent the bill of sale to the escrow agent handling the deal on April 8. Mr. Rochoff, PepsiCo's corporate counsel, spoke with Janas about the standard contract sent by Janas to PepsiCo. He noted only that the delivery date should be changed.

[7] On Monday, April 7, the aircraft was flown to Savannah, Georgia for the pre-purchase inspection. Quaid was present at the inspection for Klein. Archie Walker, PepsiCo's chief of maintenance, was present for the seller. Walker and Quaid discussed a list of repairs to be made to the jet. Most of the problems were cured during the inspection. However, one cosmetic problem was to be corrected in New York, and there were cracks in the engine blades of the right engine.

[8] On April 8, a boroscopic examination conducted by Aviall revealed eight to eleven cracks on the turbine blades. Walker told Rashid that the cost of repairing the blades would be between $25,000 to $28,000. Judge Williams found in Finding of Fact numbers 34 through 37 that PepsiCo, through Walker and Rashid, agreed to pay for the repair to the engine.

[9] On April 9, the plane was returned to New York. Rashid wanted the plane grounded; however, it was sent to retrieve

the stranded PepsiCo Chairman of the Board from Dulles airport that same evening. Donald Kendall, the Chairman, on April 10, called Rashid and asked that the jet be withdrawn from the market. Rashid called Welsch who effected the withdrawal. On the 11th Janas told Klein that PepsiCo refused to tender the aircraft. The deal was supposed to close on Friday, April 11.

[10]On April 14, Klein telexed UJS demanding delivery of the aircraft. That same day, UJS telexed PepsiCo demanding delivery and expressing satisfaction with the pre-purchase inspection. On April 15, PepsiCo responded with a telex to UJS saying that it refused to negotiate further because discussions had not reached the point of agreement; in particular, Klein was not prepared to go forward with the deal.

[11]Judge Williams, in a lengthy opinion, made numerous findings of fact. Such findings are reviewed only for clear error. *Davis v. Food Lion,* 792 F.2d 1274, 1277 (4th Cir.1986). If the findings are based on determinations of witness credibility, are consistent, and are corroborated by extrinsic evidence, they are virtually never clearly erroneous. *Brown v. Baltimore and Ohio R. Co.,* 805 F.2d 1133, 1140 (4th Cir.1986).

[12]Judge Williams' decision to grant specific performance is reviewed only for an abuse of discretion. *Haythe v. May,* 223 Va. 359, 288 S.E.2d 487 (1982); *Horner v. Bourland,* 724 F.2d 1142, 1144-45 (5th Cir.1984). Keeping these standards in mind, we now turn to the first issue, whether the district court clearly erred in finding that a contract arose between PepsiCo and UJS.

II.

[13]PepsiCo argues forcefully that no contract was formed between it and UJS. The soft drink dealer argues first that the parties did not intend to be bound until a complete integration was written in final form. Until that definitive written contract existed, PepsiCo maintains that no contract

existed. The company argues that the March 31 and April 1 telexes explicitly stated that no contract would exist until a written agreement was executed. Because no written agreement had been executed (PepsiCo had not signed the sales agreement sent by Janas to PepsiCo) the company argues that it had the right to withdraw from the negotiations. PepsiCo cites *Reprosystem, B.V. v. SCM Corp.,* 727 F.2d 257, 262 (2d Cir.1984), *cert. denied,* 469 U.S. 828 (1984) and *Skycom Corp. v. Telstar Corp.,* 813 F.2d 810, 815-16 (7th Cir.1987) for the general proposition that either party can withdraw from negotiations for any reason.

[14]Upon reviewing the facts, Judge Williams ruled that a contract was formed between the parties. He explains:

> A contract was formed between UJS and PepsiCo for the sale of the GII aircraft, Serial No. 170, for $4.6 million. The contract formation is based upon (1) UJS's April 3rd confirming telex; (2) the conduct of the parties, e.g., (a) PepsiCo's failure to communicate any objection to the terms of the April 3rd telex confirming the agreement reached between Welsch and Janas; (b) PepsiCo's directive to UJS to wire transfer a One Hundred Thousand Dollar ($100,000.00) down payment, which money was received by PepsiCo; (c) PepsiCo's communication with UJS that the Sales Agreement, which served to memorialize the contract, appeared “fine”; (d) PepsiCo's execution of the Bill of Sale for the aircraft and its sending of the Bill of Sale to the escrow agent, as called for by Janas and in the Sales Agreement; (e) PepsiCo's sending the aircraft to Savannah, Georgia, for a prepurchase inspection as called for in both the April 3rd confirming telex and the Sales Agreement; and (e) admissions of PepsiCo., through Rashid, that UJS's offer to purchase the airplane was accepted.

JA 103-04, Conclusion of Law # 6. Finally, Judge Williams expressly held that the intent to memorialize the contract in writing was not necessarily a condition to the existence of the contract itself. JA 104 (Conclusion of Law number 8).

[15]PepsiCo offers no reason as to why Judge Williams' findings on this issue are clearly erroneous. They merely disagree with his characterizations of the facts. This court may disagree with his characterization too, but that does not amount to a firm and definite conviction that a mistake has been committed. *Anderson v. City of Bessemer City, N.C.,* 470 U.S. 564 (1985).

[16]PepsiCo argues secondly, that no contract was formed because the condition of inspection satisfactory to the buyer had not been met. PepsiCo urges strongly that neither UJS nor Klein were willing to accept the aircraft "as is," so the condition was unsatisfied. Judge Williams ruled that when PepsiCo agreed to make the repairs, the condition was satisfied. Furthermore, the court below ruled that the condition was excused by PepsiCo's refusal to tender the aircraft so that the buyer could express his dissatisfaction.

[17]The district court's first ruling, that the condition was satisfied by PepsiCo's offers to pay for the repairs, resolves this issue. Judge Williams ruled that based on the conversations between Walker and Rashid, the seller had agreed to make the necessary repairs to market the plane. See Finding of Fact 34-37 at JA 89-90. Again, PepsiCo offers no suggestion that Judge Williams committed any error, much less clear error. Rather, PepsiCo urges its version of the facts on this court. Without more, the company loses.

[18]Ultimately, then, a contract exists between PepsiCo and UJS for the sale of one G-II Gulfstream aircraft.[xxi] Because PepsiCo failed to deliver the aircraft, the district court ordered relief in the form of specific performance. We now consider the appropriateness of the relief ordered.

III.

[19]The Virginia Code § 8.2-716 permits a jilted buyer of goods to seek specific performance of the contract if the goods sought are unique, or in other proper circumstances. Judge Williams ruled that: 1) the G-II aircraft involved in this case is unique and 2) Klein's inability to cover with a comparable aircraft is strong evidence of "other proper circumstances." JA 111-112, Conclusions of Law No. 31 and No. 32. These conclusions are not supported in the record.

[20]We note first that Virginia's adoption of the Uniform Commercial Code does not abrogate the maxim that specific performance is inappropriate where damages are recoverable and adequate. *Griscom v. Childress,* 183 Va. 42, 31 S.E.2d 309, 311 (1944). In this case Judge Williams repeatedly stated that money damages would make Klein whole. JA 668-9, 582. Klein argued that he wanted the plane to resell it for a profit. JA 669. Finally, an increase in the cost of a replacement does not merit the remedy of specific performance. *Hilmor Sales Co. v. Helen Neuschalfer Division of Supronics Corp.,* 6 U.C.C.Rep.Serv. 325 (N.Y.Sup.Ct.1969). There is no room in this case for the equitable remedy of specific performance.

[21]Turning now to the specific rulings of the court below, Judge Williams explained that the aircraft was unique because only three comparable aircraft existed on the market. Therefore, Klein would have to go through considerable expense to find a replacement. JA 110. Klein's expert testified that there were twenty-one other G-II's on the market, three of which were roughly comparable. JA 838-9, 1284-88. Klein's chief pilot said that other G-II's could be purchased. JA 259. Finally, we should note that UJS bought two G-II's which they offered to Klein after this deal fell through, JA 796-7, and Klein made bids on two other G-II's after PepsiCo withdrew its aircraft from the market. JA 277, 666, 694. Given these facts, we find it very difficult to support a ruling that the aircraft was so unique as to merit an order of specific performance.

[22]Judge Williams ruled further that Klein's inability to cover his loss is an "other proper circumstance" favoring specific performance. Klein testified himself that he didn't purchase another G-II because prices had started to rise. JA 693. Because of the price increase, he decided to purchase a G-III aircraft. As noted earlier, price increases alone are no reason to order specific performance. Because money damages would clearly be adequate in this case, and because the aircraft is not unique within the meaning of the Virginia Commercial Code, we reverse the grant of specific performance and remand the case to the district court for a trial on damages.

AFFIRMED IN PART, REVERSED AND REMANDED IN PART.

2.1.1 Discussion of *Klein v. Pepsico*

When the lower court considers Klein's claim for damages on remand, what amounts will he be able to recover?

Do these UCC damages fully compensate Klein for all of his costs? Does he bear any risks in complying with the statutory obligation to mitigate losses that the statute imposes on the victim of a contractual breach?

2.2 Principal Case – Sedmak v. Charlie's Chevrolet, Inc.

As we have already seen, the modern use of the specific performance remedy has expanded beyond the traditional domain of land and unique goods such as artwork and antiques. However, expectation damages remain the preferred remedy, the ordinary judicial response to a breach of contract. As you read *Sedmak v. Charlie's Chevrolet* and the notes that follow, consider what might explain courts' reluctance to embrace specific performance.

Sedmak v. Charlie's Chevrolet, Inc.

Missouri Court of Appeals

622 S.W.2d 694 (1981)

SATZ, JUDGE.

[1] This is an appeal from a decree of specific performance. We affirm.

[2] In their petition, plaintiffs, Dr. and Mrs. Sedmak (Sedmaks), alleged they entered into a contract with defendant, Charlie's Chevrolet, Inc. (Charlie's), to purchase a Corvette automobile for approximately $15,000.00. The Corvette was one of a limited number manufactured to commemorate the selection of the Corvette as the Pace Car for the Indianapolis 500. Charlie's breached the contract, the Sedmaks alleged, when, after the automobile was delivered, an agent for Charlie's told the Sedmaks they could not purchase the automobile for $15,000.00 but would have to bid on it.

[3] The trial court found the parties entered into an oral contract and also found the contract was excepted from the Statute of Frauds. The court then ordered Charlie's to make the automobile "available for delivery" to the Sedmaks.

[4] Charlie's raises three points on appeal: (1) the existence of an oral contract is not supported by the credible evidence; (2) if an oral contract exists, it is unenforceable because of the Statute of Frauds; and (3) specific performance is an improper remedy because the Sedmaks did not show their legal remedies were inadequate.

[5] This was a court-tried case. The scope of our review is defined by the well-known principles set out in *Murphy v. Carron*, 536 S.W.2d 30 (Mo. 1976). We sustain the judgment of the trial court unless the judgment is not supported by substantial evidence, unless it is against the weight of the evidence or unless it erroneously declares or applies the law. Id. at 32. In conducting our review, we do not judge the credibility of witnesses. That task quite properly rests with the trial court. Rule 73.01(c)(2); *Kim Mfg., Inc. v. Superior Metal Treating, Inc.*, 537 S.W.2d 424, 428 (Mo.App.1976).

[6] In light of these principles, the record reflects the Sedmaks to be automobile enthusiasts, who, at the time of trial, owned six Corvettes. In July, 1977, "Vette Vues," a

Corvette fancier's magazine to which Dr. Sedmak subscribed, published an article announcing Chevrolet's tentative plans to manufacture a limited edition of the Corvette. The limited edition of approximately 6,000 automobiles was to commemorate the selection of the Corvette as the Indianapolis 500 Pace Car. The Sedmaks were interested in acquiring one of these Pace Cars to add to their Corvette collection. In November, 1977, the Sedmaks asked Tom Kells, sales manager at Charlie's Chevrolet, about the availability of the Pace Car. Mr. Kells said he did not have any information on the car but would find out about it. Kells also said if Charlie's were to receive a Pace Car, the Sedmaks could purchase it.

[7] On January 9, 1978, Dr. Sedmak telephoned Kells to ask him if a Pace Car could be ordered. Kells indicated that he would require a deposit on the car, so Mrs. Sedmak went to Charlie's and gave Kells a check for $500.00. She was given a receipt for that amount bearing the names of Kells and Charlie's Chevrolet, Inc. At that time, Kells had a pre-order form listing both standard equipment and options available on the Pace Car. Prior to tendering the deposit, Mrs. Sedmak asked Kells if she and Dr. Sedmak were "definitely going to be the owners."Kells replied, "yes." After the deposit had been paid, Mrs. Sedmak stated if the car was going to be theirs, her husband wanted some changes made to the stock model. She asked Kells to order the car equipped with an L82 engine, four speed standard transmission and AM/FM radio with tape deck. Kells said that he would try to arrange with the manufacturer for these changes. Kells was able to make the changes, and, when the car arrived, it was equipped as the Sedmaks had requested.

[8] Kells informed Mrs. Sedmak that the price of the Pace Car would be the manufacturer's retail price, approximately $15,000.00. The dollar figure could not be quoted more precisely because Kells was not sure what the ordered changes would cost, nor was he sure what the "appearance

package"—decals, a special paint job—would cost. Kells also told Mrs. Sedmak that, after the changes had been made, a "contract"—a retail dealer's order form—would be mailed to them. However, no form or written contract was mailed to the Sedmaks by Charlie's.

[9] On January 25, 1978, the Sedmaks visited Charlie's to take delivery on another Corvette. At that time, the Sedmaks asked Kells whether he knew anything further about the arrival date of the Pace Car. Kells replied he had no further information but he would let the Sedmaks know when the car arrived. Kells also requested that Charlie's be allowed to keep the car in their showroom for promotional purposes until after the Indianapolis 500 Race. The Sedmaks agreed to this arrangement.

[10]On April 3, 1978, the Sedmaks were notified by Kells that the Pace Car had arrived. Kells told the Sedmaks they could not purchase the car for the manufacturer's retail price because demand for the car had inflated its value beyond the suggested price. Kells also told the Sedmaks they could bid on the car. The Sedmaks did not submit a bid. They filed this suit for specific performance.

[11]Mr. Kells' testimony about his conversations with the Sedmaks regarding the Pace Car differed markedly from the Sedmaks' testimony. Kells stated that he had no definite price information on the Pace Car until a day or two prior to its arrival at Charlie's. He denied ever discussing the purchase price of the car with the Sedmaks. He admitted, however, that after talking with the Sedmaks on January 9, 1978,[xxii] he telephoned the zone manager and requested changes be made to the Pace Car. He denied the changes were made pursuant to Dr. Sedmak's order. He claimed the changes were made because they were "more favorable to the automobile" and were changes Dr. Sedmak "preferred." In ordering the changes, Kells said he was merely taking Dr. Sedmak's advice because he was a "very knowledgeable man on the Corvette."

There is no dispute, however, that when the Pace Car arrived, it was equipped with the options requested by Dr. Sedmak.

[12]Mr. Kells also denied the receipt for $500.00 given him by Mrs. Sedmak on January 9, 1978, was a receipt for a deposit on the Pace Car. On direct examination, he said he "accepted a five hundred dollar ($500) deposit from the Sedmaks to assure them the first opportunity of purchasing the car." On cross-examination, he said: "We were accepting bids and with the five hundred dollar ($500) deposit it was to give them the first opportunity to bid on the car." Then after acknowledging that other bidders had not paid for the opportunity to bid, he explained the deposit gave the Sedmaks the "last opportunity" to make the final bid. Based on this evidence, the trial court found the parties entered into an oral contract for the purchase and sale of the Pace Car at the manufacturer's suggested retail price.

[13]Charlie's first contends the Sedmaks' evidence is "so wrought with inconsistencies and contradictions that a finding of an oral contract for the sale of a Pace Car at the manufacturer's suggested retail price is clearly against the weight of the evidence." We disagree. The trial court chose to believe the Sedmaks' testimony over that of Mr. Kells and the reasonableness of this belief was not vitiated by any real contradictions in the Sedmaks' testimony. Charlie's examples of conflict are either facially not contradictory or easily reconcilable.

[14]Although not clearly stated in this point or explicitly articulated in its argument, Charlie's also appears to argue there was no contract because the parties did not agree to a price. The trial court concluded "(t)he price was to be the suggested retail price of the automobile at the time of delivery."Apparently, Charlie's argues that if this were the agreed to price, it is legally insufficient to support a contract because the manufacturer's suggested retail price is not a mandatory, fixed and definite selling price but, rather, as the term implies, it is merely a suggested price which does not

accurately reflect the market and the actual selling price of automobiles. Charlie's argument is misdirected and, thus, misses the mark.

[15]Without again detailing the facts, there was evidence to support the trial court's conclusion that the parties agreed the selling price would be the price suggested by the manufacturer. Whether this price accurately reflects the market demands on any given day is immaterial. The manufacturer's suggested retail price is ascertainable and, thus, if the parties choose, sufficiently definite to meet the price requirements of an enforceable contract. Failure to specify the selling price in dollars and cents did not render the contract void or voidable. See, e. g., *Klaber v. Lahar*, 63 S.W.2d 103, 106-107 (Mo.1933); see also § 400.2-305 RSMo 1978. 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. See *Burger v. City of Springfield*, 323 S.W.2d 777, 783-84 (Mo.1959); see also, *Allied Disposal, Inc. v. Bob's Home Service, Inc.*, 595 S.W.2d 417, 419-20 (Mo.App.1980) and § 400.2-305 RSMo 1978. This point is without merit.

[16]Charlie's next complains that if there were an oral contract, it is unenforceable under the Statute of Frauds. The trial court concluded the contract was removed from the Statute of Frauds either by the written memoranda concerning the transaction or by partial payment made by the Sedmaks. We find the latter ground a sufficient answer to defendant's complaint. We discuss it and do not consider or address the former ground.

[17]Prior to our adoption of the Uniform Commercial Code, part payment for goods was sufficient to remove the entire contract from the Statute of Frauds. § 432.020 RSMo 1949; *Woodburn v. Cogdal*, 39 Mo. 222, 228 (1866); See *Coffman v. Fleming*, 301 Mo. 313, 256 S.W. 731, 732-733 (1923). This result followed from the logical assumption that money

normally moves from one party to another not as a gift but for a bargain. The basis of this rule is the probative value of the act—part payment shows the existence of an agreement. 3 SALES & BULK TRANSFERS UNDER U.C.C., (Bender), § 2.04(5) at 2-96. However, "[t]his view overlooks the fact that, although ... part payment of the price does indicate the existence of an agreement, [it does] not reveal [the agreement's] quantity term, a key provision without which the court cannot reconstruct the contract fairly and provide against fraudulent claims."1 HAWKLAND, A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE (1964), § 1.1202 at 28. Thus, under this rule a buyer who orally purchased one commercial unit for $10.00 could falsely assert he purchased 100 units and, then, by also asserting a $10.00 payment was part payment on the 100 units, he could, in theory and in practice, convince the trier of fact that the contract entered into was for 100 units. The Code attempts to correct this defect by providing that part payment of an oral contract satisfies the Statute of Frauds only "with respect to goods for which payment has been made and accepted ...." § 400.2-201(3)(c) RSMo 1978. Under this provision, part payment satisfies the Statute of Frauds, not for the entire contract, but only for that quantity of goods to which part payment can be apportioned.[xxiii] This change simply reflects the rationale that part payment alone does not establish the oral contract's quantity term.

[18]In correcting one problem, however, the change creates another problem when, as in the instant case, payment for a single unit sale has been less than full. Obviously, this part payment cannot be apportioned and, thus, the question arises how shall this subsection of the Code be applied. The few courts that have considered this question have used opposing logic and, thus, reached opposing answers. At least one court reads and applies the changed provision literally and denies the enforcement of the oral contract because payment has

not been received in full. *Williamson v. Martz*, 11 Pa. Dist. & Co. R.2d 33, 35 (1956). The *Williamson* Court reasoned:

> Under the code, part payment takes the case out of the statute only to the extent for which payment has been made. The code therefore makes an important change by denying the enforcement of the contract where in the case of a single object the payment made is less than the full amount.

Id. at 35.

[19]Charlie's argues for this view. Other courts infer that part payment for one unit is still sufficient evidence that a contract existed between the parties and enforce the oral contract. *Lockwood v. Smigel*, 18 Cal.App.3d 800, 96 Cal.Rptr. 289 (1971); *Starr v. Freeport Dodge, Inc.*, 54 Misc.2d 271, 282 N.Y.S.2d 58 (N.Y.Dist.1967); see also, *Paloukos v. Intermountain Chevrolet Company*, 99 Idaho 740, 588 P.2d 939, 944 (1978); *Bertram Yacht Sales, Inc. v. West*, 209 So.2d 677, 679 (Fla.App.1968); *Thomaier v. Hoffman Chevrolet, Inc.*, 64 A.D.2d 492, 410 N.Y.S.2d 645, 648-649 (1978). We are persuaded by the cogency of the logic supporting this view.

[20]Admittedly, § 400.2-201(3)(c) does validate a divisible contract only for as much of the goods as has been paid for. However, this subsection was drafted to provide a method for enforcing oral contracts where there is a quantity dispute. See *Lockwood v. Smigel*, *supra*, 18 Cal.App.3d 800, 96 Cal.Rptr. at 291; see also, 1 HAWKLAND, *supra* at 28. The subsection does not necessarily resolve the Statute of Frauds problem where there is no quantity dispute. Neither the language of the subsection nor its logical dictates necessarily invalidate an oral contract for an indivisible commercial unit where part payment has been made and accepted. If there is no dispute as to quantity, the part payment still retains its probative value to prove the existence of the contract.

[21]Moreover, where, as here, there is no quantity dispute, part payment evidences the existence of a contract as satisfactorily as would a written memorandum of agreement under the liberalized criteria of the Code. The Code establishes only three basic requirements for a written memorandum to take an oral contract out of the Statute of Frauds."First, it must evidence a contract for the sale of goods; second it must be 'signed,' a word which includes any authentication which identifies the party to be charged; and third, it must specify a quantity." § 400.2-201 RSMo 1978, U.C.C., Comment 1. Here, part payment evidences the contract for the sale of goods—the car. The party to be charged—Charlie's—is identified as the one who received payment. The quantity is not in dispute because the Sedmaks are claiming to have purchased one unit—the car. Thus, part payment here evidences the existence of a contract as satisfactorily as would a written memorandum of agreement under the Code. *Lockwood v. Smigel*, 18 Cal.App.3d 800, 96 Cal.Rptr. 289, 291 (1971); see also *Paloukos v. Intermountain Chevrolet Co.*, 99 Idaho 740, 588 P.2d 939, 944 (1978).

[22]Finally, the Code has not changed the basic policy of the Statute of Frauds.

> The purpose of the Statute of Frauds is to prevent the enforcement of alleged promises that were never made; it is not, and never has been, to justify the contractors in repudiating promises that were in fact made.

Corbin, *The Uniform Commercial Code; Should It Be Enacted?* 59 YALE L.J. 821, 829 (1950). Enforcement of the oral contract here carries out the purpose of the Statute of Frauds. Denial of the contract's existence frustrates that purpose. The present contract could not have contemplated less than one car. If the part payment is believed, it must have been intended to buy the entire car not a portion of the car. Thus, denying the contract because part payment cannot be apportioned encourages fraud rather than discouraging it.

"The Statute of Frauds would be used to cut down the trusting buyer rather than to protect the one who, having made his bargain, parted with a portion of the purchase price as an earnest of his good faith." *Starr v. Freeport Dodge, Inc.*, *supra*, 54 Misc.2d 271, 282 N.Y.S.2d at 61.

[23]We hold, therefore, that where, as here, there is no dispute as to quantity, part payment for a single indivisible commercial unit validates an oral contract under § 400.2-201(3)(c) RSMo 1978.

[24]Finally, Charlie's contends the Sedmaks failed to show they were entitled to specific performance of the contract. We disagree. Although it has been stated that the determination whether to order specific performance lies within the discretion of the trial court, *Landau v. St. Louis Public Service Co.*, 273 S.W.2d 255, 259 (Mo.1954), this discretion is, in fact, quite narrow. When the relevant equitable principles have been met and the contract is fair and plain, "'specific performance goes as a matter of right.'" *Miller v. Coffeen*, 280 S.W.2d 100, 102 (Mo.1955). Here, the trial court ordered specific performance because it concluded the Sedmaks "have no adequate remedy at law for the reason that they cannot go upon the open market and purchase an automobile of this kind with the same mileage, condition, ownership and appearance as the automobile involved in this case, except, if at all, with considerable expense, trouble, loss, great delay and inconvenience." Contrary to defendant's complaint, this is a correct expression of the relevant law and it is supported by the evidence.

[25]Under the Code, the court may decree specific performance as a buyer's remedy for breach of contract to sell goods "where the goods are unique or in other proper circumstances." § 400.2-716(1) RSMo 1978. The general term "in other proper circumstances" expresses the drafters' intent to "further a more liberal attitude than some courts have shown in connection with the specific performance of contracts of sale." § 400.2-716, U.C.C., Comment 1. This

Comment was not directed to the courts of this state, for long before the Code, we, in Missouri, took a practical approach in determining whether specific performance would lie for the breach of contract for the sale of goods and did not limit this relief only to the sale of "unique" goods. *Boeving v. Vandover*, 240 Mo.App. 117, 218 S.W.2d 175 (1945). In *Boeving*, plaintiff contracted to buy a car from defendant. When the car arrived, defendant refused to sell. The car was not unique in the traditional legal sense but, at that time, all cars were difficult to obtain because of war-time shortages. The court held specific performance was the proper remedy for plaintiff because a new car "could not be obtained elsewhere except at considerable expense, trouble or loss, which cannot be estimated in advance and under such circumstances (plaintiff) did not have an adequate remedy at law." Id. at 177-178. Thus, *Boeving*, presaged the broad and liberalized language of § 400.2-716(1) and exemplifies one of the "other proper circumstances" contemplated by this subsection for ordering specific performance. § 400.2-716, Missouri Code Comment 1. The present facts track those in *Boeving*.

[26]The Pace Car, like the car in *Boeving*, was not unique in the traditional legal sense. It was not an heirloom or, arguably, not one of a kind. However, its "mileage, condition, ownership and appearance" did make it difficult, if not impossible, to obtain its replication without considerable expense, delay and inconvenience. Admittedly, 6,000 Pace Cars were produced by Chevrolet. However, as the record reflects, this is limited production. In addition, only one of these cars was available to each dealer, and only a limited number of these were equipped with the specific options ordered by plaintiffs. Charlie's had not received a car like the Pace Car in the previous two years. The sticker price for the car was $14,284.21. Yet Charlie's received offers from individuals in Hawaii and Florida to buy the Pace Car for $24,000.00 and $28,000.00 respectively. As sensibly inferred

by the trial court, the location and size of these offers demonstrated this limited edition was in short supply and great demand. We agree, with the trial court. This case was a "proper circumstance" for ordering specific performance.

Judgment affirmed.

2.2.1 The UCC and Restatement Provisions on Specific Performance

Both the Uniform Commercial Code and the Restatement (Second) of Contracts include provisions governing the specific performance remedy. The Restatement has this to say:

§ 357. Availability of Specific Performance and Injunction

(1) Subject to the rules stated in §§ 359-69, specific performance of a contract duty will be granted in the discretion of the court against a party who has committed or is threatening to commit a breach of the duty.

(2) Subject to the rules stated in §§ 359-69, an injunction against breach of a contract duty will be granted in the discretion of the court against a party who has committed or is threatening to commit a breach of the duty if

(a) the duty is one of forbearance, or

(b) the duty is one to act and specific performance would be denied only for reasons that are inapplicable to an injunction.

§ 359. Effect of Adequacy of Damages

(1) Specific performance or an injunction will not be ordered if damages would be adequate to protect the expectation interest of the injured party.

(2) The adequacy of the damage remedy for failure to render one part of the performance due does not preclude specific performance or injunction as to the contract as a whole.

(3) Specific performance or an injunction will not be refused merely because there is a remedy for breach other than damages, but such a remedy may be considered in exercising discretion under the rule stated in § 357.

§ 360. Factors Affecting Adequacy of Damages

In determining whether the remedy in damages would be adequate, the following circumstances are significant:

(a) the difficulty of proving damages with reasonable certainty,

(b) the difficulty of procuring a suitable substitute performance by means of money awarded as damages, and

(c) the likelihood that an award of damages could not be collected.

We have already seen the relevant UCC provisions in connection with our study of *Klein v. Pepsico*, but the section is reprinted here for convenient reference and to allow for comparison to the Restatement's discussion of specific performance:

§ 2-716 Buyer's Right to Specific Performance or Replevin.

(1) Specific performance may be decreed where the goods are unique or in other proper circumstances.

(2) The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just.

(3) The buyer has a right of replevin for goods identified to the contract if after reasonable effort he is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing or if the goods have been shipped under reservation and satisfaction of the security interest in them has been made or tendered. In the case of goods bought for personal, family, or household purposes, the buyer's right of replevin vests upon acquisition of a special property, even if the seller had not then repudiated or failed to deliver.

Official Comment

Purposes of Changes: To make it clear that:

1. The present section continues in general prior policy as to specific performance and injunction against breach. However, without intending to impair in any way the exercise of the court's sound discretion in the matter, this Article seeks to further a more liberal attitude than some courts have shown in connection with the specific performance of contracts of sale.

2. In view of this Article's emphasis on the commercial feasibility of replacement, a new concept of what are "unique" goods is introduced under this section. Specific performance is no longer limited to goods which are already specific or ascertained at the time of contracting. The test of uniqueness under this section must be made in terms of the total situation which characterizes the contract. Output and requirements contracts involving a particular or peculiarly available source or market present today the typical commercial specific performance situation, as contrasted with contracts for the sale of heirlooms or priceless works of art which were usually involved in the older cases. However, uniqueness is not the sole basis of the remedy under this section for the relief

> may also be granted "in other proper circumstances" and inability to cover is strong evidence of "other proper circumstances".

2.2.2 The Meaning of "Other Proper Circumstances"

Recall that the court in *Klein v. Pepsico* refused to order specific performance because Klein could have obtained cover in the market for corporate jets. A contrasting case is *King Aircraft Sales v. Lane*, 846 P.2d 550 (Wash. App. 1993), in which the court found that specific performance was an appropriate remedy for the breach of a contract to sell collectible aircraft. As the court explained:

> [T]he planes were fairly characterized as "one of a kind" or "possibly the best" in the United States; however, it was not proved that the planes were "unique" because there were others of the same make and model available. However, the planes were so rare in terms of their exceptional condition that King had no prospect to cover its anticipated resales by purchasing alternative planes, because there was no possibility of finding similar or better planes.

Id. at 553.

2.2.3 Monetary Specific Performance

What happens if a court determines that specific performance is an appropriate remedy but the breaching seller has already sold the goods to someone else? Ordinarily, no grounds exist for recovering the goods from the innocent third-party purchaser, and it is therefore impossible to procure the goods themselves. An award of "monetary specific performance" solves this problem by ordering the seller to pay the original buyer the proceeds of the third-party sale.

Because monetary specific performance may give the buyer an amount far greater than any plausible estimate of the market-contract price differential, courts are often reluctant to exercise this power. In *Bander v. Grossman*, 161 Misc. 2d 119, 611 N.Y.S.2d 985 (1994), for example, a dealer in collectible cars failed to deliver a rare Aston

Martin because he was unable to clear the title to the vehicle. Prices of collectible automobiles are remarkably volatile, and the price of this Aston Martin fluctuated wildly during the period from contract formation to final judgment.

Time	**Price**
Contract Price (Summer 1987)	$40,000
Time of Breach (December 1987)	$60,000
Sale to Third Party (April 1989?)	$225,000
Peak Price in (July 1989)	$335,000
Time of Trial (1993?)	$80,000

The plaintiff-buyer sought to recover the $225,000 proceeds that seller received from selling the Aston Martin to a third party. The trial court refused and instead awarded $20,000 in damages, representing the market-contract price differential on the date of breach in December 1987. It appears that similar Aston Martins were quite rare, but the court concluded that had the buyer sought substitute performance in December 1987 a comparable car would have been available for purchase at $60,000. The appellate court affirmed and explained why the long delay between breach and trial militated strongly against an award of monetary specific performance.

> With the passage of time, specific performance becomes disfavored. For example, because goods are subject to a rapid change in condition, or the cost of maintenance of the goods is important, time may be found to have been of the essence, and even a month's delay may defeat specific performance….
>
> Turning to the facts of the instant case, the plaintiff did not sue in December of 1987, when it is likely a request for specific performance would have been granted. At that point, the defendant had disclaimed the contract and plaintiff was aware of his rights. The plaintiff was not protected by a continued firm assurance that defendant definitely would

> perfect the car's title…. The court does not accept plaintiff's protest that he believed the commercial relationship was intact; the parties had already had a heated discussion and were communicating through attorneys. A more likely explanation of plaintiff's inaction is that he proceeded to complete the purchase in April of 1988 of a Ferrari Testarossa for $128,000 and a Lamborghini for $40,000 in 1989.

Id. at 990.

2.2.4 American Brands v. Playgirl

In *American Brands, Inc. v. Playgirl, Inc.*, 498 F.2d 947 (2d Cir. 1974), the Second Circuit confronted a conflict about cigarette advertising on the back cover of *Playgirl* magazine. Since the first publication of the magazine, American Brands had contracted with Playgirl to run their ads on the back cover of every issue. Citing a desire to diversify their advertising base, Playgirl repudiated the contract and refused to continue the cigarette ads. American Brands asserted that "back cover advertising is not fungible, and that Playgirl alone and uniquely provides an advertising audience composed of young, malleable, and affluent females." The appellate court was unimpressed with the evidence American Brands produced concerning the uniqueness of the *Playgirl* readership and refused to award specific performance.

A contrasting case from Illinois granted an injunction in favor of PC Brand and distinguished *American Brands v. Playgirl* in the following terms:

> *American Brands* is clearly distinguishable from this case. PC Brand is a much smaller company than American Brands, Inc., a tobacco company, and its target market is more limited. PC Brand is a mail order computer company, whose only clients come from its magazine advertisements, which include mail and telephone order forms. In contrast, American Brands, Inc.'s advertising targets are much more diverse. Moreover, the

> tobacco company was not structured around an advertising and discount scheme as was PC Brand, and it would not have suffered irreparable injury nor been put out of business due to the absence of one advertising vehicle.

Davis v. Ziff Communications Co., 553 N.E.2d 404, 434 (Ill. 1989).

2.2.5 Alan Schwartz's Case for Specific Performance

Professor Alan Schwartz has argued that specific performance should be the remedial rule rather than the exception. In the excerpt that follows, he summarizes the main lines of argument:

> Specific performance is the most accurate method of achieving the compensation goal of contract remedies because it gives the promisee the precise performance that he purchased. The natural question, then, is why specific performance is not routinely available. Three explanations of the law's restrictions on specific performance are possible. First, the law's commitment to the compensation goal may be less than complete; restricting specific performance may reflect an inarticulate reluctance to pursue the compensation goal fully. Second, damages may generally be fully compensatory. In that event, expanding the availability of specific performance would create opportunities for promisees to exploit promisors by threatening to compel, or actually compelling, performance, without furthering the compensation goal. The third explanation is that concerns of efficiency or liberty may justify restricting specific performance, despite its greater accuracy; specific performance might generate higher transaction costs than the damage remedy, or interfere more with the liberty interests of promisors. The first justification is beyond the scope of the analysis here. The second and third explanations will be examined in detail.

With respect to the second justification, current doctrine authorizes specific performance when courts cannot calculate compensatory damages with even a rough degree of accuracy. If the class of cases in which there are difficulties in computing damages corresponds closely to the class of cases in which specific performance is now granted, expanding the availability of specific performance is obviously unnecessary. Further, such an expansion would create opportunities for promisees to exploit promisors. The class of cases in which damage awards fail to compensate promisees adequately is, however, broader than the class of cases in which specific performance is now granted. Thus the compensation goal supports removing rather than retaining present restrictions on the availability of specific performance.

It is useful to begin by examining the paradigm case for granting specific performance under current law, the case of unique goods. When a promisor breaches and the promisee can make a transaction that substitutes for the performance the promisor failed to render, the promisee will be fully compensated if he receives the additional amount necessary to purchase the substitute plus the costs of making a second transaction. In some cases, however, such as those involving works of art, courts cannot identify which transactions the promisee would regard as substitutes because that information often is in the exclusive possession of the promisee. Moreover, it is difficult for a court to assess the accuracy of a promisee's claim. For example, if the promisor breaches a contract to sell a rare emerald, the promisee may claim that only the Hope Diamond would give him equal satisfaction, and thus may sue for the price difference between the emerald and the diamond. It would be difficult for a court to know whether this claim is true. If the court seeks to award money damages, it has three choices: granting the price differential, which may overcompensate the promisee; granting the dollar value of the promisee's foregone satisfaction as estimated by the court, which may overcompensate or undercompensate; or granting restitution of any sums paid, which undercompensates the promisee. The promisee is fully compensated without risk of overcompensation or undercompensation if the remedy of specific performance is available to him and its use encouraged by the doctrine that damages must be foreseeable and certain.

If specific performance is the appropriate remedy in such cases, there are three reasons why it should be routinely available. The first reason is that in many cases damages actually are undercompensatory. Although promisees are entitled to incidental damages, such damages are difficult to monetize. They consist primarily of the costs of finding and making a second deal, which generally involve the expenditure of time rather than cash; attaching a dollar value to such opportunity costs is quite difficult. Breach can also cause frustration and anger, especially in a consumer context, but these costs also are not recoverable.

Substitution damages, the court's estimate of the amount the promisee needs to purchase an adequate substitute, also may be inaccurate in many cases less dramatic than the emerald hypothetical discussed above. This is largely because of product differentiation and early obsolescence. As product differentiation becomes more common, the supply of products that will substitute precisely for the promisor's performance is reduced. For example, even during the period when there is an abundant supply of new Datsuns for sale, two-door, two-tone Datsuns with mag wheels, stereo, and air conditioning may be scarce in some local markets. Moreover, early obsolescence gives the promisee a short time in which to make a substitute purchase. If the promisor breaches late in a model year, for example, it may be difficult for the promisee to buy the exact model he wanted. For these reasons, a damage award meant to enable a promisee to purchase "another car" could be undercompensatory.

In addition, problems of prediction often make it difficult to put a promisee in the position where he would have been had his promisor performed. If a breach by a contractor would significantly delay or prevent completion of a construction project and the project differs in important respects from other projects—for example, a department store in a different location than previous stores—courts may be reluctant to award "speculative" lost profits attributable to the breach.

Second, promisees have economic incentives to sue for damages when damages are likely to be fully compensatory. A breaching promisor is reluctant to perform and may be hostile. This makes specific performance an unattractive remedy in cases in which the promisor's performance is complex, because the promisor is more likely to render a defective performance when that performance is coerced, and the defectiveness of complex performances is sometimes difficult to establish in court. Further, when the promisor's performance must be rendered over time, as in construction or requirements contracts, it is costly for the promisee to monitor a reluctant promisor's conduct. If the damage remedy is compensatory, the promisee would prefer it to incurring these monitoring costs. Finally, given the time necessary to resolve lawsuits, promisees would commonly prefer to make substitute transactions promptly and sue later for damages rather than hold their affairs in suspension while awaiting equitable relief. The very fact that a promisee requests specific performance thus implies that damages are an inadequate remedy.

The third reason why courts should permit promisees to elect routinely the remedy of specific performance is that promisees possess better information than courts as to both the adequacy of damages and the difficulties of coercing performance. Promisees know better than courts whether the damages a court is likely to award would be adequate because promisees are more familiar with the costs that breach imposes on them. In addition, promisees generally know more about their promisors than do courts; thus they are in a better position to predict whether specific performance decrees would induce their promisors to render satisfactory performances.

In sum, restrictions on the availability of specific performance cannot be justified on the basis that damage awards are usually compensatory. On the contrary, the compensation goal implies that specific performance should be routinely available.

> This is because damage awards actually are undercompensatory in more cases than is commonly supposed; the fact of a specific performance request is itself good evidence that damages would be inadequate; and courts should delegate to promisees the decision of which remedy best satisfies the compensation goal. Further, expanding the availability of specific performance would not result in greater exploitation of promisors. Promisees would seldom abuse the power to determine when specific performance should be awarded because of the strong incentives that promisees face to seek damages when these would be even approximately compensatory.

Alan Schwartz, *The Case for Specific Performance*, 89 YALE L.J. 271, 774-78 (1979).

2.2.6 The Goetz & Scott Approach to Breach and Mitigation

A competing view of the same problem begins instead with the potentially valuable role of mitigation. In the following passage, Charles Goetz and Robert Scott argue that a seller decides to breach when the buyer can more cheaply obtain substitute performance.

> There may be circumstances ... in which the obligee can more advantageously make all or part of the adjustment. For example, Buyer may be able to install adjustable windows, use temporary air conditioning units, or even delay occupancy until the strike is settled. Seller would be foolish under such circumstances to adjust autonomously; that would not be the cheapest way to satisfy his performance obligation. Seller would instead prefer that Buyer readjust, even though Seller will have to bear the resulting expense. One can characterize an obligor's decision to breach, therefore, as an election to surrender irrevocably his option to perform—a request

> that the obligee bear all future adjustment costs, with damages provided as reimbursement. Breach is the obligor's signal that: "My assessment of our relative capacities suggests that you enjoy the comparative advantage on all prospective adjustments. Therefore, please undertake all cost-minimizing adjustments and send me the bill." In essence, breach involves a final commitment to quasi-performance (breach with damages) as the most efficient means of satisfying the original contractual obligation.
>
> This approach rests on the general principle that we should design legal rules to reduce the parties' joint costs of contracting. Efficient damage rules must encourage both parties to participate in reducing the costs of breach. When the obligor announces her decision to breach, it becomes a "cry for help" intended to enlists the aid of the obligee in obtaining substitute performance as cheaply as possible. The conventional expectation damage measure joins with the avoidability doctrine to give the obligor an option to breach and pay the obligee's cost of cover rather than continuing with performance regardless of its cost. An award of specific performance, in contrast, gives the obligee an unconditional right to receive the promised performance from the obligor. If the remedy of specific performance were routinely available, obligees would have far fewer incentives to cooperate.

Charles J. Goetz and Robert E. Scott, The Mitigation Principle: Toward a General Theory of Contractual Obligation, 69 VA. L. REV. 967, 979-80 (1983).

2.2.7 Discussion of Specific Performance

Does the UCC follow the traditional common law approach to awarding specific performance?

What does *Sedmak* teach us about the meaning of "other proper circumstances"?

Is *King Aircraft* consistent with this understanding of the doctrine?

Can you reconcile Sedmak and King Aircraft with Klein v. Pepsico?

In *Bander v. Grossman*, the court could have awarded damages measured as of the time of breach, the time of suit, the time of cover, or the time of final judgment. Which approach is best, and why?

What do you suppose explains why case law and statutes express a strong preference for damages rather than the remedy of specific performance?

Thinking more broadly about the policy justifications for awarding specific performance, what advantages does this remedy have over damages? What ideas does the excerpt by Alan Schwartz add to the conventional case for specific performance?

Consider the concluding sentence of the Schwartz excerpt:

> Promisees would seldom abuse the power to determine [whether] specific performance should be awarded because of the strong incentives promisees face to seek damages when these would be even approximately compensatory.

Can you think of any other (less benign) reason to seek specific performance?

3 Limitations on Damages

In this section, we consider more closely the main doctrinal limitations on monetary damages—foreseeability, certainty and mitigation. Our discussion of the hypo based on *Globe Refining* introduced the idea that courts refuse to compensate a promisee for unforeseeable losses. As we will soon see, the venerable English case of *Hadley v. Baxendale* defines the basic contours of a rule that promisees may recover only for those losses that were reasonably foreseeable at the time of contracting. Recall also that in *Freund v. Washington Square Press*, the certainty limitation prevented Freund from recovering any loss of royalties due to the failure to publish his book on modern drama. We consider here the related problem of recovering lost profits from a new business and see in *Drews Company v. Ledwith-Wolfe Associates* how the doctrinal requirement of reasonable certainty may cause significant under-compensation. Finally, recall that in the *Globe Refining* hypo, a doctrine of avoidable consequences precluded recovery for damages that the promisee could have taken cost-justified steps to mitigate. See Restatement § 350; UCC § 2-715. In *Rockingham County v. Luten Bridge Co.*, we will see how the repudiation of a contract may present the promisee with surprisingly difficult decisions about mitigation and significant potential risks. Finally, *Parker v. Twentieth Century Fox* shows us how mitigation doctrine applies to one (very lucrative) employment contract and poses the challenging question of whether a promisee should have to accept an offer of substitute performance from the breaching party.

3.1 Principal Case – *Hadley v. Baxendale*

The foreseeability doctrine is most often associated with the following famous 19^{th} Century English case.

Hadley v. Baxendale
Court of Exchequer
9 Exch. 341, 156 Eng. Rep. 145 (1854)

> [1] [Reporter's Headnote:] At the trial before Crompton, J., at the last Gloucester Assizes, it appeared that the plaintiffs carried on an extensive business as millers at Gloucester; and that, on the 11^{th} of May, their mill was stopped by a breakage of the crank shaft by which the mill was worked. The steam-engine was manufactured by Messrs. Joyce & Co., the engineers, at Greenwich, and it became necessary to send the shaft as a pattern for a new one to Greenwich. The fracture was discovered on the 12^{th}, and on the 13^{th} the plaintiffs sent one of their servants to the office of the defendants, who are the well-known carriers trading under the name of Pickford & Co., for the purpose of having the shaft carried to Greenwich. The plaintiffs' servant told the clerk that the mill was stopped, and that the shaft must be sent immediately; and in answer to the inquiry when the shaft would be taken,

the answer was, that if it was sent up by twelve o'clock any day, it would be delivered at Greenwich on the following day. On the following day the shaft was taken by the defendants, before noon, for the purpose of being conveyed to Greenwich, and the sum of 2£ 4s. was paid for its carriage for the whole distance; at the same time the defendants' clerk was told that a special entry, if required, should be made to hasten its delivery. The delivery of the shaft at Greenwich was delayed by some neglect; and the consequence was, that the plaintiffs did not receive the new shaft for several days after they would otherwise have done, and the working of their mill was thereby delayed, and they thereby lost the profits they would otherwise have received.

[2] On the part of the defendants, it was objected that these damages were too remote, and that the defendants were not liable with respect to them. The learned Judge left the case generally to the jury, who found a verdict with 25£ damages beyond the amount paid into Court.

[3] Whateley, in last Michaelmas Term, obtained a rule nisi for a new trial, on the ground of misdirection.

ALDERSON, B.

[4] We think that there ought to be a new trial in this case; but, in so doing, we deem it to be expedient and necessary to state explicitly the rule which the Judge, at the next trial, ought, in our opinion, to direct the jury to be governed by when they estimate the damages.

[5] Indeed, it is of the last importance that we should do this; for, if the jury are left without any definite rule to guide them, it will, in such cases as these, manifestly lead to the greatest injustice. The Courts have done this on several occasions; and in *Blake v. Midland Railway Company* (18 Q. B. 93), the Court granted a new trial on this very ground, that the rule had not been definitely laid down to the jury by the learned Judge at Nisi Prius.

[6] "There are certain establishing rules", this Court says, in *Alder v. Keighley* (15 M. & W. 117), "according to which the jury ought to find". And the Court, in that case, adds: "and here there is a clear rule, that the amount which would have been received if the contract had been kept, is the measure of damages if the contract is broken."

[7] Now we think the proper rule in such a case as the present is this:-- 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. Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated. But, on the other hand, if these special circumstances were wholly unknown to the party breaking the contract, he, at the most, could only be supposed to have had in his contemplation the amount of injury which would arise generally, and in the great multitude of cases not affected by any special circumstances, from such a breach of contract. For, had the special circumstances been known, the parties might have specially provided for the breach of contract by special terms as to the damages in that case; and of this advantage it would be very unjust to deprive them. Now the above principles are those by which we think the jury ought to be guided in estimating the damages arising out of any breach of contract. It is said, that other cases such as breaches of contract in the

nonpayment of money, or in the not making a good title of land, are to be treated as exceptions from this, and as governed by a conventional rule. But as, in such cases, both parties must be supposed to be cognizant of that well-known rule, these cases may, we think, be more properly classed under the rule above enunciated as to cases under known special circumstances, because there both parties may reasonably be presumed to contemplate the estimation of the amount of damages according to the conventional rule. Now, in the present case, if we are to apply the principles above laid down, we find that the only circumstances here communicated by the plaintiffs to the defendants at the time of the contract was made, were, that the article to be carried was the broken shaft of a mill, and that the plaintiffs were the millers of the mill.

[8] But how do these circumstances shew reasonably that the profits of the mill must be stopped by an unreasonable delay in the delivery of the broken shaft by the carrier to the third person? Suppose the plaintiffs had another shaft in their possession put up or putting up at the time, and that they only wished to send back the broken shaft to the engineer who made it; it is clear that this would be quite consistent with the above circumstances, and yet the unreasonable delay in the delivery would have no effect upon the intermediate profits of the mill. Or, again, suppose that, at the time of the delivery to the carrier, the machinery of the mill had been in other respects defective, then, also, the same results would follow. Here it is true that the shaft was actually sent back to serve as a model for the new one, and that the want of a new one was the only cause of the stoppage of the mill, and that the loss of profits really arose from not sending down the new shaft in proper time, and that this arose from the delay in delivering the broken one to serve as a model. But it is obvious that, in the great multitude of cases of millers sending off broken shafts to third persons by a carrier under ordinary circumstances, such consequences would not, in all

probability, have occurred; and these special circumstances were here never communicated by the plaintiffs to the defendants. It follows therefore, that the loss of profits here cannot reasonably be considered such a consequence of the breach of contract as could have been fairly and reasonably contemplated by both the parties when they made this contract. For such loss would neither have flowed naturally from the breach of this contract in the great multitude of such cases occurring under ordinary circumstances, nor were the special circumstances, which, perhaps, would have made it a reasonable and natural consequence of such breach of contract, communicated to or known by the defendants. The Judge ought, therefore, to have told the jury that upon the facts then before them they ought not to take the loss of profits into consideration at all in estimating the damages. There must therefore be a new trial in this case.

Rule absolute.

3.1.1 The Facts of *Hadley v. Baxendale*

There is an apparent discrepancy between the account of the facts contained in the Reporter's Headnote and the factual basis for Baron Alderson's analysis of the case. A subsequent English case attempted to clear up the confusion in the following way:

> In considering the meaning and application of these rules it is essential to bear clearly in mind the facts on which *Hadley v. Baxendale* proceeded. The headnote is definitely misleading insofar as it says that the defendant's clerk, who attended at the office, was told that the mill was stopped and that the shaft must be delivered immediately. The same allegation figures in the statement of facts which are said on page 344 to have "appeared" at the trial before Crompton, J. If the Court of Exchequer had accepted these facts as established, the court must, one would suppose, have decided the case the other way round…. But it is reasonably plain

> from Alderson B.'s judgment that the court rejected this evidence, for on page 355 he says: "We find that the only circumstances here communicated by the plaintiffs to the defendants at the time when the contract was made were that the article to be carried was the broken shaft of a mill and that the plaintiffs were the millers of the mill."

Victoria Laundry (Windsor) Ltd. v. Newman Indus. Ltd., 2 K.B. 528, 537 (1940).

3.1.2 The Contemporary Applicability of ***Hadley***

Professor Richard Danzig has argued that *Hadley*'s approach to foreseeability no longer suits the realities of contemporary contracting behavior.

> [I]n *Hadley v. Baxendale* the court spoke as though entrepreneurs were universally flexible enough and enterprises were small enough for individuals to be able to serve "notice" over the counter of specialized needs calling for unusual arrangements. But in mass-transaction situations a seller cannot plausibly engage in an individualized "contemplation" of the consequences of breach and a subsequent tailoring of a transaction. In the course of his conversion of a family business into a modern industrial enterprise, Baxendale [the company's managing director] made Pickfords itself into an operation where the contemplation branch of the rule in *Hadley v. Baxendale* was no longer viable. Even in the 1820's the Pickfords' operations were "highly complex"…. A century later most enterprises fragment and standardize operations…. This development—and the law's recognition of it—makes it self-evidently impossible to serve legally cognizable notice on, for example, an airline that a scheduled flight is of special importance or on the telephone company that

> uninterrupted service is particularly vital at a particular point in a firm's business cycle….
>
> The inadequacies of the rule are masked by still more fundamental phenomena which render the case of very limited relevance to the present economy. At least in mass-transaction situations, the modern enterprise manager is not concerned with his corporation's liability as it arises from a particular transaction, but rather with liability when averaged over the full run of transactions of a given type. In the mass-production situation the run of these transactions will average his consequential-damages pay-out in a way far more predictable than a jury's guesses about the pay-out. In other words, for this type of entrepreneur—a type already emerging at the time of *Hadley v. Baxendale*, and far more prevalent today—there is no need for the law to provide protection from the aberrational customer; his own market and self-insurance capacities are great enough for the job.

Richard Danzig, Hadley v. Baxendale: *A Study in the Industrialization of the Law*, 4 J. LEGAL STUD. 249, 279-83 (1975).

3.1.3 Discussion of *Hadley v. Baxendale*

The court says that "it is obvious that in the great multitude of cases of millers sending off broken shafts to third persons" the mill would not ordinarily be stopped. Is this true?

Suppose that you go to the local United Parcel Service office to ship a box of diamonds. What is the effect of the *Hadley* rule on parties like you who have a special susceptibility to consequential damages?

How will you likely change your behavior in response to the foreseeability limitation on damages? How is UPS likely to respond?

Suppose now that you moved to a jurisdiction in which an anti-*Hadley* default rule of unlimited consequential damages prevailed.

How are carriers like Pickford & Co. or UPS likely to adapt to this new default rule?

Danzig asserts that the increasingly complex nature of modern enterprises makes it "self-evidently impossible to serve legally cognizable notice on" an airline that a scheduled flight is of special importance or a phone company that uninterrupted service is particularly vital. Can you think of any response to this critique of the *Hadley* rule?

In another portion of the same article, Danzig proposed that courts should evaluate the foreseeability of consequential damages at the time of breach rather than at the time of contracting. What would be the probable effect of such a change?

3.2 Introduction to the Certainty Limitation

Courts routinely require plaintiffs to prove any loss from a breach of contract with reasonable certainty. The Restatement (Second) of Contracts expresses this requirement in the following terms:

> **§ 352. Uncertainty as a Limitation on Damages**
>
> Damages are not recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty.
>
> Comment:
>
> a. *Requirement of certainty*. A party cannot recover damages for breach of a contract for loss beyond the amount that the evidence permits to be established with reasonable certainty. Courts have traditionally required greater certainty in the proof of damages for breach of a contract than in the proof of damages for a tort. The requirement does not mean, however, that the injured party is barred from recovery unless he establishes the total amount of his loss. It merely excludes those elements of loss that cannot be proved with reasonable certainty. The main impact of the requirement of certainty comes in connection with

recovery for lost profits. Although the requirement of certainty is distinct from that of foreseeability (§ 351), its impact is similar in this respect. Although the requirement applies to damages based on the reliance as well as the expectation interest, there is usually little difficulty in proving the amount that the injured party has actually spent in reliance on the contract, even if it is impossible to prove the amount of profit that he would have made. In such a case, he can recover his loss based on his reliance interest instead of on his expectation interest.

Doubts are generally resolved against the party in breach. A party who has, by his breach, forced the injured party to seek compensation in damages should not be allowed to profit from his breach where it is established that a significant loss has occurred. A court may take into account all the circumstances of the breach, including willfulness, in deciding whether to require a lesser degree of certainty, giving greater discretion to the trier of the facts. Damages need not be calculable with mathematical accuracy and are often at best approximate. See Comment 1 to Uniform Commercial Code § 1-106. This is especially true for items such as loss of good will as to which great precision cannot be expected. Furthermore, increasing receptiveness on the part of courts to proof by sophisticated economic and financial data and by expert opinion has made it easier to meet the requirement of certainty.

b. *Proof of profits.* The difficulty of proving lost profits varies greatly with the nature of the transaction. If, for example, it is the seller who claims lost profit on the ground that the buyer's breach has caused him to lose a sale, proof of lost profit will ordinarily not be difficult. If, however, it is the buyer who claims lost profit on the ground that the seller's breach has caused him loss in other transactions, the task of proof is harder. Furthermore, if the transaction is more complex and extends into the future, as where the seller agrees to furnish all of the buyer's requirements over a period of years, proof of the loss of profits caused by the seller's breach is more difficult. If the breach prevents the injured party from carrying on a well-established business, the resulting loss of profits can often be proved with sufficient certainty. Evidence of past performance will form the basis for a reasonable prediction as to the future.. However, if the business is a new one or if it is a speculative one that is subject to great fluctuations in volume, costs or prices, proof will be more difficult. Nevertheless, damages may be established with reasonable certainty with the aid of expert testimony, economic and financial data, market surveys and analyses, business records of similar enterprises, and the like. Under a contract of exclusive agency for the sale of goods on commission, the agent can often prove with sufficient certainty the profits that he would have made had he not been discharged. Proof of the sales made by the agent in the agreed territory before the breach, or of the sales made there by the principal after the breach, may permit a reasonably accurate estimate of the agent's loss of commissions. However, if the agency is not an exclusive one, so that the agent's ability to withstand competition is in question, such a showing will be more difficult, although the agent's past record may give a sufficient basis for judging this.

3.3 Principal Case – Drews Company v. Ledwith-Wolfe Associates

Drews Company, Inc. v. Ledwith-Wolfe Associates, Inc.

Supreme Court of South Carolina

371 S.E.2d 532 (1988)

HARWELL, JUSTICE:

[1] This case involves the breach of a construction contract. We affirm the trial court's refusal to grant a new trial, but reverse the jury's award of lost profits.

FACTS

[2] The Drews Company, Inc. ("Contractor") contracted to renovate a building owned by Ledwith-Wolfe Associates, Inc. ("Owner"). Owner intended to convert the building into a restaurant. From its inception, the project was plagued by construction delays, work change orders, and general disagreement over the quality of work performed. Contractor eventually pulled its workers off the project. Contractor later filed, then sued to foreclose, a mechanic's lien for labor and materials used in renovating the building. Owner counterclaimed, alleging Contractor breached the contract and forced Owner to rework part of the job. Owner also claimed that Contractor's delays in performance caused Owner to lose profits from the restaurant.

[3] The jury returned an $18,000 verdict for Contractor on its complaint. The jury awarded Owner $22,895 on its counterclaim for re-doing and completing the work and $14,000 in lost profits caused by Contractor's delays. The trial judge denied Contractor's new trial motion and awarded Owner attorney's fees and costs pursuant to S.C. Code Ann. § 29-5-10 (Supp.1987) (mechanics' liens).

A.

[4] Contractor first argues that the trial court erred in admitting evidence of Owner's "delay damages" because the

contract contained no completion date or statement that "time was of the essence." We disagree.

[5] A contractor may be liable for delay damages regardless of whether time was of the essence of the contract. 17A C.J.S. CONTRACTS § 502(4)(a) (1963). Where a contract sets no date for performance, time is not of the essence of the contract and it must be performed within a reasonable time. *General Sprinkler Corp. v. Loris Industrial Developers, Inc.,* 271 F.Supp. 551, 557 (D.S.C.1967); *see Davis v. Cordell,* 115 S.E.2d 649 (S.C. 1960) (applying "reasonable time" rule to time for payment under contract); *Cloniger v. Cloniger,* 193 S.E.2d 647 (S.C. 1973) (applying "reasonable time" rule to agreement to repurchase property within an unspecified time); *Smith v. Spratt Machine Co.,* 24 S.E. 376 (S.C. 1896) (where manufacturing contract specified no time for performance, "reasonable time" implied); *see also* 17A C.J.S. CONTRACTS § 503(a)(1) (1963) ("reasonable time" for performance will be implied where no time therefor is fixed in building or construction contract). The timeliness of Contractor's performance here was a disputed factual issue properly reserved for jury determination.

B.

[6] Contractor's next exception presents this Court with an opportunity to address a legal issue unsettled in South Carolina: Does the "new business rule" operate to automatically preclude the recovery of lost profits by a new business or enterprise? We hold that it does not.

1. Lost Profits in South Carolina

[7] We begin our analysis of the lost profits issue by recognizing an elementary principle of contract law. The purpose of an award of damages for breach is "to give compensation, that is, to put the plaintiff in as good a position as he would have been in had the contract been performed." 11 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS, § 1338 (3d ed. 1968). The proper measure of

that compensation, then, "is the loss actually suffered by the contractee as the result of the breach." *South Carolina Finance Corp. v. West Side Finance Co.,* 113 S.E.2d 329, 335 (S.C. 1960).

[8] "Profits" have been defined as "the net pecuniary gain from a transaction, the gross pecuniary gains diminished by the cost of obtaining them." *Restatement of Contracts* § 331, Comment B (1932); *see Mali v. Odom,* 367 S.E.2d 166 (S.C. Ct. App. 1988) (defining "profits" as the net of income over expenditures during a given period). Profits lost by a business as the result of a contractual breach have long been recognized as a species of recoverable consequential damages in this state. *Hollingsworth on Wheels, Inc. v. Arkon Corp.,* 305 S.E.2d 71 (S.C. 1983); *South Carolina Finance Corp. v. West Side Finance Co., supra.* The issue is more difficult, however, when a new or unestablished business is the aggrieved party seeking projected lost profits as damages.

[9] The new business rule as a per se rule of nonrecoverability of lost profits was firmly established in this state in *Standard Supply Co. v. Carter & Harris,* 62 S.E. 150, 152 (S.C. 1907): "When a business is in contemplation, but not established or not in actual operation, profit merely hoped for is too uncertain and conjectural to be considered." *McMeekin v. Southern Ry. Co.,* 64 S.E. 413 (S.C. 1909), like *Standard Supply Co.,* involved profits allegedly lost when a carrier failed to deliver machinery necessary for a new mill enterprise. The Court adhered to a strict application of the rule, stating that "[t]he plaintiff's business had not been launched, and therefore he could not recover profits he expected to make." 64 S.E. at 415; cited in *Currie v. Davis,* 126 S.E. 119 (S.C. 1923) (new business rule applied to preclude recovery of lost profits where carrier's tort against passenger delayed production by passenger's cotton gin "not yet in active operation").

[10]Modern cases, however, reflect the willingness of this Court and our Court of Appeals to view the new business rule as a rule of evidentiary sufficiency rather than an

automatic bar to recovery of lost profits by a new business. *See Hollingsworth on Wheels, Inc. v. Arkon Corp., supra* (holding that while aggrieved buyer's projections of lost profits from new business enterprise introduced unreasonable amount of uncertainty into damages computation, evidence sufficient to permit Court itself to reach reasonable figure for profits lost); *Bryson v. Arcadian Shores, Inc.,* 257 S.E.2d 233 (S.C. 1979) (evidence of room revenues allegedly lost by hotel as result of construction delay held speculative and insufficient to allow recovery); *Mali v. Odom, supra* (attorney malpractice action-estimates of anticipated monthly income from new school held speculative and without reasonable basis where offered without reference to operational history or standard method for estimations); *Petty v. Weyerhaeuser Co.,* 288 S.C. 349, 342 S.E.2d 611 (S.C. Ct. App. 1986) (tort action-three month period business operated prior to debilitating effect of tort afforded basis for fairly and reasonably approximating lost profits). These cases have so eroded the new business rule as an absolute bar to recovery of lost profits that the rigid *Standard Supply Co.* rule is no longer good law.

2. A Multi-Jurisdictional Trend

[11]South Carolina has not been alone in developing its evidentiary view of the new business rule. Numerous authorities and commentators have tracked a similar trend nationwide: "Courts are now taking the position that the distinction between established businesses and new ones is a distinction that goes to the weight of the evidence and not a rule that automatically precludes recovery of profits by a new business." D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES, § 3.3, at 155 (1973). *See* R. DUNN, RECOVERY OF DAMAGES FOR LOST PROFITS, § 4.2 (3d ed. 1987) (trend of modern cases plainly toward replacing old rule of law with rule of evidence-reasonable certainty); Comment, *Remedies-Lost Profits as Contract Damages for an Unestablished Business: The New Business Rule Becomes Outdated,* 56 N.C.L. REV. 693, 695 (1978) (noting "increasing trend either to create exceptions

and mitigating sub-doctrines to the new business rule or simply to recognize that its rationale is no longer persuasive"); Note, *The New Business Rule And The Denial Of Lost Profits,* 48 OHIO ST. L.J. 855, 859 (1987) (clear and growing majority of courts apply new business rule as rule delimiting sufficiency of evidence). Moreover, application of the rule in this manner has been applauded as fairer than mechanical application of the old rule. *See* D. DOBBS, *supra* (as a matter of evidence, new business/established business distinction makes sense; as a matter of setting an inflexible rule, it does not); R. DUNN, *supra,* at 227 (no worthwhile end achieved "by permitting one party to breach his contracts with impunity—giving him an option, as it were—because the other party has not yet commenced operation.").

[12]In light of the facts before us, we find particularly persuasive several cases involving lost profits flowing from breaches of contracts to construct and/or lease buildings for the operation of new business ventures. *See, e.g., Chung v. Kaonohi Center Co.,* 618 P.2d 283 (Haw. 1980) (rejecting per se nonrecoverability version of new business rule in favor of "reasonable certainty" evidentiary standard; lost profits award upheld for breach of contract to lease space for new restaurant); *Welch v. U.S. Bancorp Realty and Mortgage,* 596 P.2d 947 (Or. 1979) (breach of contract to advance funds for residential and commercial development on land tract; "reasonable certainty" standard applied); *Fera v. Village Plaza, Inc.,* 242 N.W.2d 372 (Mich. 1976) (breach of lease of shopping center space for new book store; per se rule of nonrecoverability rejected in favor of broad jury discretion in lost profits determinations); *Smith Dev. Corp. v. Bilow Enterprises, Inc.,* 308 A.2d 477 (R.I. 1973) (tortious interference with contractual right to erect "McDonald's" restaurant; "reasonable certainty" rule applied and per se new business rule rejected); *S. Jon Kreedman & Co. v. Meyer Bros. Parking-Western Corp.,* 58 Cal.App.3d 173, 130 Cal.Rptr. 41 (1976) (breach of contract to construct parking garage and lease it to

operator; "hard and fast" new business rule rejected in favor of "reasonable certainty" test).

[13]We believe South Carolina should now unequivocally join those jurisdictions applying the new business rule as a rule of evidentiary sufficiency and not as an automatic preclusion to recovery of lost profits by a new business or enterprise.

3. The Standard for Entitlement to Lost Profits

[14]The same standards that have for years governed lost profits awards in South Carolina will apply with equal force to cases where damages are sought for a new business or enterprise. First, profits must have been prevented or lost "as a natural consequence of" the breach of contract. *South Carolina Finance Corp., supra,* at 122, 113 S.E.2d at 335; *Charles v. Texas Co.,* 18 S.E.2d 719, 729 (S.C. 1942) (lost profits are proper elements of damages where they are "direct and necessary result" of defendant's breach).

The second requirement is foreseeability; a breaching party is liable for those damages, including lost profits, "which may reasonably be supposed to have been within the contemplation of the parties at the time the contract was made as a probable result of the breach of it." *National Tire & Rubber Co. v. Hoover,* 122 S.E. 858, 859 (S.C. 1924); *see also Traywick v. Southern Ry. Co.,* 50 S.E. 549 (S.C. 1905); *Colvin v. McCormick Cotton Oil Co.,* 44 S.E. 380 (S.C. 1902); *Sitton v. MacDonald,* 60 Am.Rep. 484 (S.C. 1885) (lost profits cases citing the "knowledge of special circumstances" rule of *Hadley v. Baxendale,* 9 Ex. 341, 156 Eng. Rep. 154 (1854)).

[15]The crucial requirement in lost profits determinations is that they be "established with reasonable certainty, for recovery cannot be had for profits that are conjectural or speculative." *South Carolina Finance Corp., supra,* 113 S.E.2d at 336. "The proof must pass the realm of conjecture, speculation, or opinion not founded on facts, and must consist of actual facts from which a reasonably accurate conclusion regarding the cause and the amount of the loss

can be logically and rationally drawn." 22 Am. Jur. 2d *Damages* § 641 (1988).

[16]Numerous proof techniques have been discussed and accepted in different factual scenarios. *See, e.g., Upjohn v. Rachelle Laboratories, Inc.,* 661 F.2d 1105, 1114 (6th Cir.1981) (proof of future lost profits based on marketing forecasts by employees specializing in economic forecasting); *Petty v. Weyerhaeuser Co., supra* (skating rink's projected revenues compared to those of another arena in a nearby town); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 352, at 146 (1981) (proof of lost profits "may be established with reasonable certainty with the aid of expert testimony, economic and financial data, market surveys and analyses, business records of similar enterprises, and the like."); Note, *supra,* 48 OHIO ST. L.J. at 872-3 (means of proving prospective profits include (1) "yardstick" method of comparison with profit performance of business similar in size, nature, and location; (2) comparison with profit history of plaintiff's successor, where applicable; (3) comparison of similar businesses owned by plaintiff himself, and (4) use of economic and financial data and expert testimony). While the factual contexts in which new business/lost profits cases arise will undoubtedly vary, these methods of proof and the "reasonable certainty" requirement bear an inherent flexibility facilitating the just assessment of profits lost to a new business due to contractual breach.

4. Application of the Standard to the Present Facts

[17]Applying this standard to the facts before us, we find that Owner's proof failed to clear the "reasonable certainty" hurdle. Owner's projections of the profits lost by the restaurant because of the breach were based on nothing more than a sheet of paper reflecting the gross profits the restaurant made in the first 11 months of operation after construction was completed. These figures were not supplemented with corresponding figures for overhead or operating expenditures, but only with Owner's testimony that

he "would expect at least a third of that [gross figure] to be" net profit. Owner's expectations, unsupported by any particular standard or fixed method for establishing net profits, were wholly insufficient to provide the jury with a basis for calculating profits lost with reasonable certainty. *South Carolina Finance Corp., supra; Mali v. Odom, supra.*

[18]The trial judge erred in failing to rule that, as a matter of law, Owner's proof was insufficient to merit submission to the jury. The $14,000 award of lost profits must therefore be reversed.

C.

[19]Contractor's remaining exceptions are disposed of pursuant to Supreme Court Rule 23. *See Talley v. South Carolina Higher Education Tuition Grants Committee,* 347 S.E.2d 99 (S.C. 1986) (issue neither presented to nor ruled upon by trial court not preserved for appeal); *Reid v. Hardware Mutual Insurance Co.,* 166 S.E.2d 317 (S.C. 1969) (questions not raised by proper exception will not be considered); Supreme Court Rule 8, § 3; *Howell v. Pacific Columbia Mills,* 354 S.E.2d 384 (S.C. 1987) (exceptions not argued in brief deemed abandoned on appeal).

[20]Costs and attorneys' fees under Supreme Court Rule 38 shall be assessed against appellant.

AFFIRMED IN PART; REVERSED IN PART.

3.3.1 Other Applications of the Certainty Limitation

The *Drews* court refers in paragraph 12 to another case involving delayed construction. In *Fera v. Village Plaza*, the court awarded lost profits for the plaintiffs' "book and bottle shop" after hearing "days of testimony" about projected revenues and costs from this new venture.

In contrast, courts have been reluctant to award lost profits damages when a breach of contract causes the promisee to suffer a loss of good will with current or prospective customers. Typical of these decisions is the following:

> Our research fails to reveal any judicial authority in Pennsylvania which sustains, under the Sales Act, a recovery for a loss of good will occasioned either by non-delivery or by the delivery of defective goods. As this Court stated in *Michelin Tire Co. v. Schulz*, 295 Pa. 140, 144: "so far as appears, the tires in question were all used by defendant's customers and paid for, so he lost nothing thereon. What he claims is that, because the tires were less durable than recommended, he lost customers, which otherwise he would have retained and whose business would have netted him a profit…. This is entirely too speculative and not the proper measure of damages." … We are in agreement with the statement of the Court in *Armstrong Rubber Co. v. Griffith*, 43 F.2d 689, 691 (2d Cir.), that: "If the plaintiff here can recover for loss of good will, it is difficult to see what limits are to be set to the recovery of such damages in any case where defective goods are sold (or where goods are not delivered) and the vendee loses customers. Indeed, if such were the holding, damages which the parties never contemplated would seem to be involved in every contract of sale."

Harry Rubin & Sons v. Consolidated Pipe Co., 153 A.2d 472, 476-77 (Pa. 1959).

One unusual exception to this general rule is *Redgrave v. Boston Symphony Orchestra*, 855 F.2d 888 (1st Cir. 1988). Vanessa Redgrave alleged that the BSO wrongfully canceled her appearances with the orchestra after stories appeared about her support for the Palestine Liberation Organization. She sought damages for "a significant number of movie and theatre offers that she would ordinarily have received [but that] were in fact not offered to her as a result of BSO's cancellation." After reducing to $12,000 the jury's award of $100,000 in consequential damages, the court opined that:

> a plaintiff may receive consequential damages if the plaintiff proves with sufficient evidence that a breach of contact proximately caused the loss of identifiable professional opportunities. This type of claim is sufficiently different from a nonspecific allegation of damage to reputation that it appropriately falls outside the general rule that reputation damages are not an acceptable form of contract damage.

Id. at 894.

Finally, in *Smith v. Penbridge Associates*, 655 A.2d 1015 (Pa. Super. Ct. 1995), the court confronted an unusual twist on the lost profit problem. A Michigan emu farm sold two male emus to a Pennsylvania couple with a guarantee that they were a "proven breeding pair." The purchasers discovered the farm's mistake when the emus produced no eggs during the ensuing breeding season. Despite the fact that emu farming was a new business in Pennsylvania, the court granted plaintiffs' claim for lost profits damages based on the projected number of eggs that a breeding pair would have produced.

3.3.2 Discussion of the Certainty Limitation

In *Drews*, what exactly was the proof of lost profits that the plaintiff offered? How certain can you be in counseling a client about the recovery of lost profits?

One might reasonably object that refusing to award uncertain future profits on the ground that they are too speculative causes expectation damages to be systematically under-compensatory. Consider, however, how awarding lost profits from a business might over-compensate the plaintiff. How do you suppose that those profits will be measured?

Will the court's calculations take into account the cost of the capital that plaintiff has invested in the business?

How about the risk of business failure and the difference between earning profits over a period of years and receiving a lump sum damage award?

3.4 Introduction to Avoidability and Mitigation

We have encountered several times the so-called "mitigation principle" which implies that damages for breach of contract exclude any loss that the promisee could have reasonably avoided. One important consequence of this rule is that the announcement of a breach of contract requires the promisee to decide how to respond. She may seek substitute performance—a covering transaction—or she may choose to delay covering and take her chances in the evolving market for the originally promised performance. Here is what the Restatement (Second) of Contracts has to say on the subject:

> **§ 350. Avoidability as a Limitation on Damages**
>
> (1) Except as stated in Subsection (2), damages are not recoverable for loss that the injured party could have avoided without undue risk, burden or humiliation.
>
> (2) The injured party is not precluded from recovery by the rule stated in Subsection (1) to the extent that he has made reasonable but unsuccessful efforts to avoid loss.
>
> Comment:
>
> a. *Rationale*. The rules stated in this Section reflect the policy of encouraging the injured party to attempt to avoid loss. The rule stated in Subsection (1) encourages him to make such efforts as he can to avoid loss by barring him from recovery for loss that he could have avoided if he had done so. See Comment b. The exception stated in Subsection (2) protects him if he has made actual efforts by allowing him to recover, regardless of the rule stated in

Subsection (1), if his efforts prove to be unsuccessful. See Comment h. See also Comment c to § 347.

b. *Effect of failure to make efforts to mitigate damages*. As a general rule, a party cannot recover damages for loss that he could have avoided by reasonable efforts. Once a party has reason to know that performance by the other party will not be forthcoming, he is ordinarily expected to stop his own performance to avoid further expenditure. Furthermore, he is expected to take such affirmative steps as are appropriate in the circumstances to avoid loss by making substitute arrangements or otherwise. It is sometimes said that it is the "duty" of the aggrieved party to mitigate damages, but this is misleading because he incurs no liability for his failure to act. The amount of loss that he could reasonably have avoided by stopping performance, making substitute arrangements or otherwise is simply subtracted from the amount that would otherwise have been recoverable as damages.

c. *Substitute transactions*. When a party's breach consists of a failure to deliver goods or furnish services, for example, it is often possible for the injured party to secure similar goods or services on the market. If a seller of goods repudiates, the buyer can often buy similar goods elsewhere. If an employee quits his job, the employer can often find a suitable substitute. Similarly, when a party's breach consists of a failure to receive goods or services, for example, it is often possible for the aggrieved party to dispose of the goods or services on the market. If a buyer of goods repudiates, the seller can often sell the goods elsewhere. If an employer fires his employee, the employee can often find a suitable job elsewhere. In such cases as these, the injured party is expected to make appropriate efforts to avoid loss by arranging a substitute transaction. If he does not do so, the amount of loss that he could have avoided by doing so is subtracted in calculating his damages. In the case of the sale of goods, this principle has inspired the standard formulas under which a buyer's or seller's damages are based on the difference between the contract price and the market price on that market where the injured party could have arranged a substitute transaction for the purchase or sale of similar goods. See Uniform Commercial Code §§ 2-708, 2-713. Similar rules are applied to other contracts, such as contracts for the sale of securities, where there is a well-established market for the type of performance involved, but the principle extends to other situations in which a substitute transaction can be arranged, even if there is no well-established market for the type of performance. However, in those other situations, the burden is generally put on the party in breach to show that a substitute transaction was available, as is done in the case in which an employee has been fired by his employer.

d. *"Lost volume."* The mere fact that an injured party can make arrangements for the disposition of the goods or services that he was to supply under the contract does not necessarily mean that by doing so he will avoid loss. If he would have entered into both transactions but for the breach, he has "lost volume" as a result of the breach. See Comment f to § 347. In that case the second transaction is not a "substitute" for the first one.

e. *What is a "substitute."* Whether an available alternative transaction is a suitable substitute depends on all the circumstances, including the similarity of the performance and the times and places that they would be rendered. If discrepancies between the transactions can be adequately compensated for in damages, the alternative transaction is regarded as a substitute and such damages are awarded. If the party in breach offers to perform the contract for a different price, this may amount to a suitable alternative. But this is not the case if the offer is conditioned on surrender by the injured party of his claim for breach.

f. *Time for arranging substitute transaction*. The injured party is expected to arrange a substitute transaction within a reasonable time after he learns of the breach. He is expected to do this even if the breach takes the form of an anticipatory repudiation, since under the rule stated in Subsection (2) he is then protected against the possibility of a change in the market before the time for performance. See Comment g. The injured party may, however, make appropriate efforts to urge the repudiating party to perform in spite of his repudiation or to retract his repudiation, and these efforts will be taken into account in determining what is a reasonable time. Although the injured party is expected to arrange a substitute transaction without unreasonable delay following the anticipatory repudiation, the time for performance under the substitute transaction will ordinarily be the same time as it would have been under the original contract.

g. *Efforts expected*. In some situations, it is reasonable for the injured party to rely on performance by the other party even after breach. This may be true, for example, if the breach is accompanied by assurances that performance will be forthcoming. In such a situation the injured party is not expected to arrange a substitute transaction although he may be expected to take some steps to avoid loss due to a delay in performance. Nor is it reasonable to expect him to take steps to avoid loss if those steps may cause other serious loss. He need not, for example, make other risky contracts, incur unreasonable expense or inconvenience or disrupt his business. In rare

> instances the appropriate course may be to complete performance instead of stopping. Finally the aggrieved party is not expected to put himself in a position that will involve humiliation, including embarrassment or loss of honor and respect.
>
> h. *Actual efforts to mitigate damages*. Sometimes the injured party makes efforts to avoid loss but fails to do so. The rule stated in Subsection (2) protects the injured party in that situation if the efforts were reasonable. If, for example, a seller who is to manufacture goods for a buyer decides, on repudiation by the buyer, "in the exercise of reasonable commercial judgment for the purpose of avoiding loss" to complete manufacture of the goods, he is protected under Uniform Commercial Code § 2-704(2) even if it later appears that he could have better avoided loss by stopping manufacture. Similarly, if a buyer of goods who decides, on repudiation by the seller, to "'cover' by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller," he is protected under Uniform Commercial Code § 2-712. See also Uniform Commercial Code § 2-706 for the seller's comparable right of resale. The rule stated in Subsection (2) reflects the policy underlying these Code provisions, one encouraging the injured party to make reasonable efforts to avoid loss by protecting him even when his efforts fail. To this extent, his failure to avoid loss does not have the effect stated in Subsection (1). Under the rule stated in § 347, costs incurred in a reasonable but unsuccessful effort to avoid loss are recoverable as incidental losses. See Comment c to § 347.

The first of the mitigation cases below shows what can happen when the promisor's repudiation of the contract is ambiguous. In the second case, the promisee must decide whether or not to accept an offer of substitute performance from the breaching promisor.

3.5 Principal Case – Rockingham County v. Luten Bridge Co.

Rockingham County v. Luten Bridge Co.
Circuit Court of Appeals, Fourth Circuit
35 F.2d 301 (1929)

PARKER, CIRCUIT JUDGE.

[1] This was an action at law instituted in the court below by the Luten Bridge Company, as plaintiff, to recover [from] Rockingham County, North Carolina, an amount alleged to be due under a contract, but defendant contends that notice of cancellation was given the bridge company before the erection of the bridge was commenced, and that it is liable only for the damages which the company would have sustained, if it had abandoned construction at that time. The judge below refused to strike out an answer filed by certain members of the board of commissioners of the county, admitting liability in accordance with the prayer of the complaint, allowed this pleading to be introduced in evidence as the answer of the county, excluded evidence offered by the county in support of its contentions as to notice of cancellation and damages, and instructed a verdict for plaintiff for the full amount of its claim. From judgment on this verdict the county has appealed.

[2] The facts out of which the case arises, as shown by the affidavits and offers of proof appearing in the record, are as follows: 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 received this resignation on the same day, and immediately accepted same and noted his acceptance thereon. Later in the day, Pruitt called him over the telephone and stated that he wished to withdraw the resignation, and later sent him written notice to the same effect. The clerk, however, paid no attention to the attempted withdrawal, and proceeded on the next day to appoint one W. W. Hampton as a member of the board to succeed him.

[3] After his resignation, Pruitt attended no further meetings of the board, and did nothing further as a commissioner of the county. Likewise Pratt and McCollum, the other two members of the board who had voted with him in favor of the contract, attended no further meetings. Hampton, on the other hand, took the oath of office immediately upon his appointment and entered upon the discharge of the duties of a commissioner. He met regularly with the two remaining members of the board, Martin and Barber, in the courthouse at the county seat, and with them attended to all of the business of the county. Between the 12th of February and the first Monday in December following, these three attended, in all, 25 meetings of the board.

[4] At one of these meetings, a regularly advertised called meeting held on February 21st, 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.

[5] At the regular monthly meeting of the board on March 3d, 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. At the regular monthly meeting on April 7th, a resolution was passed, reciting that the board had been informed that one of its members was privately insisting that the bridge be constructed. It repudiated this action on the part of the member and gave notice that it would not be recognized. At the September meeting, a resolution was passed to the effect that the board would pay no bills presented by plaintiff or anyone connected with the bridge. At the time of the passage of the first resolution, very little work toward the construction of the bridge had been done, it being estimated that the total cost of labor done and material on the ground was around $1,900; but, notwithstanding the repudiation of the contract by the county, the bridge company continued with the work of construction.

[6] On November 24, 1924, plaintiff instituted this action against Rockingham County, and against Pruitt, Pratt, McCollum, Martin, and Barber, as constituting its board of commissioners. Complaint was filed, setting forth the execution of the contract and the doing of work by plaintiff thereunder, and alleging that for work done up until November 3, 1924, the county was indebted in the sum of $18,301.07. On November 27th, three days after the filing of the complaint, and only three days before the expiration of the term of office of the members of the old board of commissioners, Pruitt, Pratt, and McCollum met with an attorney at the county seat, and, without notice to or consultation with the other members of the board, so far as appears, had the attorney prepare for them an answer admitting the allegations of the complaint. This answer, which was filed in the cause on the following day, did not purport to be an answer of the county, or of its board of commissioners, but of the three commissioners named.

[7] 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. These attorneys immediately moved to strike out the answer which had been filed by Pruitt, Pratt, and McCollum, and entered into an agreement with opposing counsel that the county should have 30 days from the action of the court on the motion within which to file answer. The court denied the motion on June 2, 1927, and held the answer filed by Pruitt, Pratt, and McCollum to be the answer of the county. An order was then entered allowing the county until August 1st to file answer, pursuant to stipulation, within which time the answer of the county was filed. This 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. A reply was filed to this, and the case finally came to trial.

[8] At the trial, plaintiff, over the objection of the county, was allowed to introduce in evidence, the answer filed by Pruitt, Pratt, and McCollum, the contract was introduced, and proof was made of the value under the terms of the contract of the work done up to November 3, 1924. The county elicited on cross-examination proof as to the state of the work at the time of the passage of the resolutions to which we have referred. It then offered these resolutions in evidence, together with evidence as to the resignation of Pruitt, the acceptance of his resignation, and the appointment of Hampton; but all of this evidence was excluded, and the jury was instructed to return a verdict for plaintiff for the full amount of its claim. The county preserved exceptions to the rulings which were adverse to it, and contends that there was error on the part of the judge below in denying the motion to strike out the answer filed by Pruitt, Pratt, and McCollum; in allowing same to be introduced in evidence; in excluding the evidence offered of the resignation of Pruitt, the acceptance

of his resignation, and the appointment of Hampton, and of the resolutions attempting to cancel the contract and the notices sent plaintiff pursuant thereto; and in directing a verdict for plaintiff in accordance with its claim.

[From this point in the opinion through paragraph 21, the court embarks on a complex analysis of who had authority to act on behalf of the County. The discussion is included here to give you a sense of the uncertainty surrounding this crucial legal issue. However, the rules for identifying "de facto officers" are not central to our study of avoidability doctrine and you may therefore wish to skim this portion of the court's opinion.]

[9] 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, and the exceptions must be considered with this in mind. Upon these exceptions, three principal questions arise for our consideration, viz.' (1) Whether the answer filed by Pruitt, Pratt, and McCollum was the answer of the county. If it was, the lower court properly refused to strike it out, and properly admitted it in evidence. (2) Whether, in the light of the evidence offered and excluded, the resolutions to which we have referred, and the notices sent pursuant thereto, are to be deemed action on the part of the county. If they are not, the county has nothing upon which to base its position as to minimizing damages, and the evidence offered was properly excluded. And (3) whether plaintiff, if the notices are to be deemed action by the county, can recover under the contract for work done after they were received, or is limited to the recovery of damages for breach of contract as of that date.

[10]With regard to the first question the learned District Judge held that the answer of Pruitt, Pratt, and McCollum was the answer of the county, but we think that this holding was based upon an erroneous view of the law. It appears, without contradiction, not only that their answer purports to have been filed by them individually, and not in behalf of the county or of the board of commissioners, but also that it was

not authorized by the board of commissioners, acting as a board at a meeting regularly held. It appears that Pruitt, Pratt, and McCollum merely met at the county seat to consider the filing of an answer to plaintiff's complaint. This was not a "regular" meeting of the board, held on the first Mondays of December and June. It was not a "special" meeting held on the first Monday in some other month. It was not shown to be a meeting "called" by the chairman upon the written request of a member of the board, and advertised at the courthouse door and in a newspaper as provided by statute. Consol. St. Sec. 1296. And between the filing of the complaint and the filing of the answer there was not sufficient time for the advertising of a called meeting of the board. Consequently any action taken by Pruitt, Pratt, and McCollum with regard to filing an answer was not taken at a meeting of the board in legal session. Even if it be assumed that Pruitt continued to be a member of the board, and that he, Pratt, and McCollum constituted a majority thereof, nevertheless such majority could bind the county only by action taken at a meeting regularly held. The rule is well settled that the governing board of a county can act only as a body and when in legal session as such. 7 R.C.L. 941; 15 C.J. 460 and cases cited; *O'Neal v. Wake County*, 196 N.C. 184, 145 S.E. 28, 29; *Grand Island & N.W.R. Co. v. Baker*, 6 Wyo. 369, 45 P. 494, 34 L.R.A. 835, 71 Am. St. Rep. 926; *Board of Com'rs of Jasper County v. Allman*, 142 Ind. 573, 42 N.E. 206, 39 L.R.A. 58, 68; *Campbell County v. Howard & Lee*, 133 Va. 19, 112 S.E. 876; *Paola, etc. R. Co. v. Anderson County Com'rs*, 16 Kan. 302, 310. As said in the case last cited: "…Commissioners casually meeting have no power to act for the county. There must be a session of the 'board.' This single entity, the 'board,' alone can by its action bind the county. And it exists only when legally convened."

[11]The North Carolina case of *Cleveland Cotton-Mills v. Commissioners*, 108 N.C. 678, 13 S.E. 271, 274, established the rule in North Carolina. That case arose under the old law,

which required bridge contracts involving more than $500 to be made with the concurrence of a majority of the justices of the peace of the county. Such a contract was made, and a majority of the justices of the county, who were not then in session, executed a written instrument approving it. Afterwards, at a regular meeting of the justices with the board of commissioners, a majority of the quorum of the justices present voted to ratify the contract. A divided court held that this ratification at the regular meeting was sufficient, although the majority of the quorum which voted for ratification was less than a majority of all of the justices of the county; but all of the members of the court agreed that the execution of the instrument by a majority of the justices when not in session was without effect. As to this, it was said in the majority opinion:

> We attach no importance to the paper signed by an actual majority of the whole number of justices of the peace of the county. The action contemplated by the law was that of the justices of the peace in a lawfully constituted meeting as a body, as in cases where the validity of an agreement made by the governing officials of any other corporation is drawn in question. *Duke v. Markham*, 105 N.C. 131, 10 S.E. 1017 (18 Am. St. Rep. 889).

[12]It will be seen that the court applied to this case, where the validity of the action of the governing officials of a public corporation was drawn in question, the rule laid down in *Duke v. Markham*, which is, of course, the well-settled rule in the case of private corporation, *viz.* that such officials can exercise their powers as members of the governing board only at a meeting regularly held. See, also, *First National Bank v. Warlick*, 125 N.C. 593, 34 S.E. 687; *Everett v. Staton*, 192 N.C. 216, 134 S.E. 492.

[13]But in the case of *O'Neal v. Wake County*, *supra*, decided in 1928, the Supreme Court of North Carolina set at rest any

doubt which may have existed in that state as to the question here involved. In holding that the county could not be held liable on a contract made at a joint meeting of the county commissioners, the county board of education, and a representative of the insurance department, the court said:

> A county makes its contracts through the agency of its board of commissioners; but to make a contract which shall be binding upon the county the board must act as a body convened in legal session, regular, adjourned, or special. A contract made by members composing the board when acting in their individual and not in their corporate capacity while assembled in a lawful meeting is not the contract of the county. As a rule authorized meetings are prerequisite to corporate action based upon deliberate conference and intelligent discussion of proposed measures. 7 R.C.L. 941; 15 C.J. 460; 43 C.J. 497; *P.&F.R. Ry. Co. v. Com'rs of Anderson County*, 16 Kan. 302; *Kirkland v. State*, 86 Fla. 84, 97 So. 502. The principle applies to corporations generally, and by the express terms of our statute, as stated above, every county is a corporate body.

[14]We think, therefore, that Pruitt, Pratt, and McCollum, even if they constituted a majority of the board of commissioners, did not bind the county by their action in filing an answer admitting its liability, where no meeting of the board of commissioners was held according to law, and where, so far as appears, the other commissioners were not even notified of what was being attempted. It is unthinkable that the county should be held bound by such action, especially where the commissioners attempting to bind it had taken no part in its government for nearly 10 months, and where the answer filed did not defend it in any particular, but, on the contrary, asserted its liability. If, therefore, the answer be considered as an attempt to answer on behalf of the

county, it must be stricken out, because not authorized by its governing board; if considered as to the answer of Pruitt, Pratt, and McCollum individually, it must go out because, having been sued in their official capacity, they had no right to answer individually. And, of course, not having been authorized by the county, the answer was not admissible as evidence against it on the trial of the cause.

[15]Coming to the second inquiry—i.e., whether the resolutions to which we have referred and the notices sent pursuant thereto are to be deemed the action of the county, and hence admissible in evidence on the question of damages— it is to be observed that, along with the evidence of the resolutions and notices, the county offered evidence to the effect that Pruitt's resignation had been accepted before he attempted to withdraw same, and that thereafter Hampton was appointed, took the oath of office, entered upon the discharge of the duties of the office, and with Martin and Barber transacted the business of the board of commissioners until the coming into office of the new board. We think that this evidence, if true, shows (1) that Hampton, upon his appointment and qualification, became a member of the board in place of Pruitt, and that he, Martin, and Barber constituted a quorum for the transaction of its business; and (2) that, even if this were not true, Hampton was a de factor commissioner, and that his presence at meetings of the board with that of the other two commissioners was sufficient to constitute a quorum, so as to give validity to its proceedings.

[16]The North Carolina statutes make no provision for resignations by members of the boards of county commissioners. A public officer, however, has at common law the right to resign his office, provided his resignation is accepted by the proper authority. *Hoke v. Henderson*, 15 N.C. 1, 25 Am.Dec. 677; *U.S. v. Wright*, Fed. Cas. No. 16,775; *Rowe v. Tuck*, 149 Ga. 88, 99 S.E. 303, 5 A.L.R. 113; *Van Orsdall v. Hazard*, 3 Hill (N.Y.) 243; *Philadelphia v. Marcer*, 8 Phila. (Pa.) 319; *Gates v. Delaware County*, 12 Iowa, 405; 22 R.C.L. 556,

557; note, 19 A.L.R. 39, and cases there cited. And, in the absence of statute regulating the matter, his resignation should be tendered to the tribunal or officer having power to appoint his successor. 22 R.C.L. 558; *State v. Popejoy*, 165 Ind. 177, 74 N.E. 994, 6 Ann.Cas. 687, and note; *State ex rel. Conley v. Thompson*, 100 W.Va. 253, 130 S.E. 456; *State v. Huff*, 172 Ind. 1, 87 N.E. 141, 139 Am. St. Rep. 355; *State v. Augustine*, 113 Mo. 21, 20 S.W. 651, 35 Am. St. Rep. 696. In the case last cited it is said:

> It is well-established law that, in the absence of express statutory enactment, the authority to accept the resignation of a public officer rests with the power to appoint a successor to fill the vacancy. The right to accept a resignation is said to be incidental to the power of appointment. 1 Dillon on Municipal Corporations (3d Ed.) § 224; Mechem on Public Offices, Sec. 413; *Van Orsdall v. Hazard*, 3 Hill (N.Y.) 243; *State v. Boecker*, 56 Mo. 17.

In North Carolina, the officer having power to appoint the successor of a member of the board of county commissioners is the clerk of the superior court of the county. Consolidated Statutes of North Carolina, Sec. 1294. It is clear, therefore, that, when Pruitt tendered his resignation to the clerk of the superior court, he tendered it to the proper authority.

[17]The mere filing of the resignation with the clerk of the superior court did not of itself vacate the office of Pruitt, it was necessary that his resignation be accepted. *Hoke v. Henderson*, *supra*; *Edwards v. U.S.*, 103 U.S. 471. But, after its acceptance, he had no power to withdraw it. *Mimmack v. U.S.*, 97 U.S. 426; *Murray v. State*, 115 Tenn. 303, 89 S.W. 101, 5 Ann.Cas. 687, and note; *State v. Augustine*, *supra*; *Gates v. Delaware County*, *supra*; 22 R.C.L. 559. If, as the offer of proof seems to indicate, the resignation of Pruitt was accepted by the clerk prior to his attempt to withdraw it, the appointment of Hampton was unquestionably valid, and the latter, with

Martin and Barber, constituted a quorum of the board of commissioners, with the result that action taken by them in meetings of the board regularly held was action by the county.

[18]But, irrespective of the validity of Hampton's appointment, we think that he must be treated as a de facto officer, and that the action taken by him, Martin, and Barber in meetings regularly held is binding upon the county and upon those dealing with it. Hampton was appointed by the lawful appointing power. He took the oath of office and entered upon the discharge of the duties of a commissioner. The only government which the county had for a period of nearly 10 months was that which he and his associates, Martin and Barber, administered. If their action respecting this contract is to be ignored, then, for the same reason, their tax levy for the year must be treated as void, and the many transactions carried through at their 25 meetings, which were not attended by Pruitt, Pratt, or McCollum, must be set aside. This cannot be the law. It ought not be the law anywhere; it certainly is not the law in North Carolina. Section 3204 of the Consolidated Statutes provides:

> 3204. Persons admitted to office deemed to hold lawfully. Any person who shall, by the proper authority, be admitted and sworn into any office, shall be held, deemed, and taken, by force of such admission, to be rightfully in such office until, by judicial sentence, upon a proper proceeding, he shall be ousted therefrom, or his admission thereto be, in due course of law, declared void.

[19]In the case of *State v. Lewis*, 107 N.C. 967, 12 S.E. 457, 458, 13 S.E. 247, 11 L.R.A. 105, the court quotes with approval the widely accepted definition and classification of de facto officers by Chief Justice Butler in the case of *State v. Carroll*, 38 Conn. 449, 9 Am. Rep. 409, as follows:

> An officer de facto is one whose acts, though not those of a lawful officer, the law, upon principles of policy and justice, will hold valid so far as they involve the interests of the public and third persons, where the duties of the office were exercised—First, without a known appointment or election, but under such circumstances of reputation or acquiescence as were calculated to induce people, without inquiry, to submit to or invoke his action, supposing him to be the officer he assumed to be; second, under color of a known and valid appointment or election, but where the officer failed to conform to some precedent requirement or condition, as to take an oath, give a bond, or the like; third, under color of a known election or appointment, void because there was a want of power in the electing or appointing body, or by reason of some defect or irregularity in its exercise, such ineligibility, want of power, or defect being unknown to the public; fourth, under color of an election or appointment by or pursuant to a public unconstitutional law before the same is adjudged to be such.

[20]It is clear that, if the appointment of Hampton be considered invalid, the case falls under the third class in the above classification; for Hampton was discharging the duties of a county commissioner under color of a known appointment, the invalidity of which, if invalid, arose from a want of power or irregularity unknown to the public. Other North Carolina cases supporting this conclusion are *Burke v. Elliott*, 26 N.C. 355, 42 Am.Dec. 142; *Burton v. Patton*, 47 N.C. 124, 62 Am.Dec. 194; *Norfleet v. Staton*, 73 N.C. 546, 21 Am.Rep. 479; *Markham v. Simpson*, 175 N.C. 135, 95 S.E. 106; *State v. Harden*, 177 N.C. 580, 98 S.E. 782; 22 R.C.L. 596, 597. This is not a case like *Baker v. Hobgood*, 126 N.C. 149, 35 S.E. 253, where there were rival boards, both attempting to

discharge the duties of office; for, upon the appointment of Hampton, Pruitt attended no further meetings and left him in the unchallenged possession of the office.

[21]The rule is well settled in North Carolina, as it is elsewhere, that the acts of a de facto officer will be held valid in respect to the public whom he represents and to third persons with whom he deals officially, notwithstanding there was a want of power to appoint him in the person or body which professed to do so. *Norfleet v. Staton*, *supra*; *Markham v. Simpson*, *supra*; 22 R.C.L. 601, 602, and cases cited.

[From this point to the end of the opinion, the court returns to the issues that are central to our discussion of mitigation and the avoidability doctrine.]

[22]Coming, then, to the third question—i.e., 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.

[23]The contrary view was expressed by Lord Cockburn in *Frost v. Knight*, L.R. 7 Ex. 111, but, as pointed out by Prof. Williston (WILLISTON ON CONTRACTS, vol. 3, p. 2347), 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 has 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.

[24]The leading case on the subject in this country is the New York case of *Clark v. Marsiglia*, 1 Denio (N.Y.) 317, 43 Am.Dec. 670. 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 plaintiff was allowed to recover as though there had been no countermand of the order; and in this the court erred. 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' Mut. Tobacco Warehouse Co.*, 186 N.C. 197, 119 S.E. 196, 198:

> 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.

> The legal right of either party to violate, abandon, or renounce his contract, on the usual terms of compensation to the other for the damages which the law recognizes and allows, subject to the jurisdiction of equity to decree specific performance in proper cases, is universally recognized and acted upon.

This is in accord with the earlier North Carolina decision of *Heiser v. Mears*, 120 N.C. 443, 27 S.E. 117, in which it was held that, where a buyer countermands his order for goods to be manufactured for him under as 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 Mfg. Co.* (C.C.A. 8th) 92 F. 486; *Davis v. Bronson*, 2 N.D. 300, 50 N.W. 836, 16 L.R.A. 655 and note, 33 Am.St.Rep. 783, and note; *Richards v. Manitowoc & Northern Traction Co.*, 140 Wis. 85, 121 N.W. 837, 133 Am.St.Rep. 1063.

[25]We have carefully considered the cases of *Roehm v. Horst*, 178 U.S. 1, *Roller v. George H. Leonard & Co.* (C.C.A. 4th) 229 F. 607, 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 v. Horst* merely follows the rule of *Hockster v. DeLaTour*, 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 v. Leonard*. In *McCoy v. Justices of Harnett County* 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, *viz.* whether, in application of the rule which requires that the party to a contract who is not in default do nothing to aggravate the damages arising from breach, he should not desist from performance of an executory contract for the erection of a structure when notified of the other party's repudiation, instead of piling up damages by proceeding with the work. As stated above, we think that reason and authority require that this question be answered in the affirmative. 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. *See Novelty Advertising Co. v. Farmers' Mut. Tobacco Warehouse Co.*, *supra*.

[26]Our conclusion, on the whole case, is that there was error in failing to strike out the answer of Pruitt, Pratt, and McCollum, and in admitting same as evidence against the county, in excluding the testimony offered by the county to which we have referred, and in directing a verdict for plaintiff. The judgment below will accordingly be reversed, and the case remanded for a new trial.

Reversed.

3.5.1 Discussion of Rockingham County v. Luten Bridge Co.

Imagine that you are counsel to the Luten Bridge Company. What should your client do in response to the first notice from the Rockingham County board of commissioners repudiating the bridge construction contract?

The court says that the Luten Bridge Company should have ceased work on the bridge after receiving notice of repudiation. Are there any risks or expenses associated with ceasing construction? Does the

Luten Bridge Company have any alternatives other than continuing or terminating the project?

3.6 Principal Case – Parker v. Twentieth Century-Fox Film Corp.

Parker v. Twentieth Century-Fox Film Corp.
Supreme Court of California
3 Cal. 3d 176, 474 P.2d 689, 89 Cal. Rptr. 737 (1970)

BURKE, J.

[1] Defendant Twentieth Century-Fox Film Corporation appeals from a summary judgment granting to plaintiff 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.

[2] Plaintiff [Shirley MacLaine] 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.

[3] 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" (hereinafter, "Big Country"). The compensation offered was identical, as were 31 of the 34 numbered provisions or articles of the original contract.[xxiv] 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.[xxv] Plaintiff was given one week within which to accept; she did not and the offer lapsed. Plaintiff then commenced this action seeking recovery of the agreed guaranteed compensation.

[4] Defendant's letter of April 4 to plaintiff, which contained both defendant's notice of breach of the “Bloomer Girl” contract and offer of the lead in “Big Country,” eliminated or impaired each of those rights. It read in part as follows: “The terms and conditions of our offer of employment are identical to those set forth in the 'BLOOMER GIRL' Agreement, Articles 1 through 34 and Exhibit A to the Agreement, except as follows:

> 1. Article 31 of said Agreement will not be included in any contract of employment regarding 'BIG COUNTRY, BIG MAN' as it is not a musical and it thus will not need a dance director.
>
> 2. In the 'BLOOMER GIRL' agreement, in Articles 29 and 32, you were given certain director and screenplay approvals and you had preapproved certain matters. Since there simply is insufficient time to negotiate with you regarding your choice of director and regarding the screenplay and since you already expressed an interest in performing the role in 'BIG COUNTRY, BIG MAN,' we must exclude from our offer of employment in 'BIG COUNTRY, BIG MAN' any approval rights as are contained in said Articles 29 and 32; however, we shall consult with you respecting the director to be selected to direct the photoplay and will further consult with you with respect to the screenplay and any revisions or changes therein, provided,

> however, that if we fail to agree ... the decision of ... [defendant] with respect to the selection of a director and to revisions and changes in the said screenplay shall be binding upon the parties to said agreement.

[5] The complaint sets forth two causes of action. The first is for money due under the contract; the second, based upon the same allegations as the first, is for damages resulting from defendant's breach of contract. Defendant in its answer admits the existence and validity of the contract, that plaintiff complied with all the conditions, covenants and promises and stood ready to complete the performance, and that defendant breached and "anticipatorily repudiated" the contract. It denies, however, that any money is due to plaintiff either under the contract or as a result of its breach, and pleads as an affirmative defense to both causes of action plaintiff's allegedly deliberate failure to mitigate damages, asserting that she unreasonably refused to accept its offer of the leading role in "Big Country."

[6] Plaintiff moved for summary judgment under Code of Civil Procedure section 437c, the motion was granted, and summary judgment for $750,000 plus interest was entered in plaintiff's favor. This appeal by defendant followed.

[7] The familiar rules are that the matter to be determined by the trial court on a motion for summary judgment is whether facts have been presented which give rise to a triable factual issue. The court may not pass upon the issue itself. Summary judgment is proper only if the affidavits or declarations[xxvi] in support of the moving party would be sufficient to sustain a judgment in his favor and his opponent does not by affidavit show facts sufficient to present a triable issue of fact. The affidavits of the moving party are strictly construed, and doubts as to the propriety of summary judgment should be resolved against granting the motion. Such summary procedure is drastic and should be used with caution so that it does not become a substitute for the open trial method of

determining facts. The moving party cannot depend upon allegations in his own pleadings to cure deficient affidavits, nor can his adversary rely upon his own pleadings in lieu or in support of affidavits in opposition to a motion; however, a party can rely on his adversary's pleadings to establish facts not contained in his own affidavits. (*Slobojan v. Western Travelers Life Ins. Co.* (1969) 70 Cal.2d 432, 436-437 [74 Cal.Rptr. 895, 450 P.2d 271]; and cases cited.) Also, the court may consider facts stipulated to by the parties and facts which are properly the subject of judicial notice. (*Ahmanson Bank & Trust Co. v. Tepper* (1969) 269 Cal.App.2d 333, 342 [74 Cal.Rptr. 774]; *Martin v. General Finance Co.* (1966) 239 Cal. App.2d 438, 442 [48 Cal.Rptr. 773]; *Goldstein v. Hoffman* (1963) 213 Cal.App.2d 803, 814 [29 Cal.Rptr. 334]; *Thomson v. Honer* (1960) 179 Cal.App.2d 197, 203 [3 Cal.Rptr. 791].)

[8] As stated, 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.

[9] 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. (*W. F. Boardman Co. v. Petch* (1921) 186 Cal. 476, 484 [199 P. 1047]; *De Angeles v. Roos Bros., Inc.* (1966) 244 Cal.App.2d 434, 441-442 [52 Cal.Rptr. 783]; *de la Falaise v. Gaumont-British Picture Corp.* (1940) 39 Cal.App.2d 461, 469 [103 P.2d 447], and cases cited; see also *Wise v. Southern Pac. Co.* (1970) 1 Cal.3d 600, 607-608 [83 Cal. Rptr. 202, 463 P.2d 426].)[xxvii] 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. (*Gonzales v. Internat. Assn. of Machinists* (1963) 213 Cal.App.2d 817, 822-824 [29 Cal.Rptr. 190]; *Harris v. Nat. Union etc. Cooks, Stewards* (1953) 116 Cal.App.2d 759, 761 [254 P.2d 673]; *Crillo v. Curtola* (1949) 91 Cal.App.2d 263, 275 [204 P.2d 941]; *de la Falaise v. Galumont-British Picture Corp.*, *supra.*, 39 Cal.App.2d 461, 469; *Schiller v. Keuffel & Esser Co.* (1963) 21 Wis.2d 545 [124 N.W.2d 646, 651]; 28 A.L.R. 736, 749; 22 Am.Jur.2d, Damages, §§ 71- 72, p. 106.)

[10]In the present case defendant has raised no issue of *reasonableness of efforts* by plaintiff 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.[xxviii]

[11]In *Harris v. Nat. Union etc. Cooks, Stewards*, *supra.*, 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.'" (P. 764 [5].) See also: *Lewis v. Protective Security Life Ins. Co.* (1962) 208 Cal.App.2d 582, 584 [25 Cal.Rptr. 213]: "*honest effort* to find

similar employment ....” (Italics added.) *de la Falaise v. Gaumont-British Picture Corp.*, *supra.*, 39 Cal.App.2d 461, 469: “reasonable effort.” *Erler v. Five Points Motors, Inc.* (1967) 249 Cal.App.2d 560, 562 [57 Cal.Rptr. 516]: Damages may be mitigated “by a showing that the employee, by the exercise of *reasonable diligence and effort*, could have procured comparable employment ....” (Italics added.) *Savitz v. Gallaccio* (1955) 179 Pa.Super. 589 [118 A.2d 282, 286]; *Atholwood Dev. Co. v. Houston* (1941) 179 Md. 441 [19 A.2d 706, 708]; *Harcourt & Co. v. Heller* (1933) 250 Ky. 321 [62 S.W.2d 1056]; *Alaska Airlines, Inc. v. Stephenson* (1954) 217 F.2d 295, 299 [15 Alaska 272]; *United Protective Workers v. Ford Motor Co.* (7th Cir. 1955) 223 F.2d 49, 52 [48 A.L.R.2d 1285]; *Chisholm v. Preferred Bankers' Life Assur. Co.* (1897) 112 Mich. 50 [70 N.W. 415]; each of which held that the *reasonableness of the* employee's *efforts*, or his excuses for failure, to find other similar employment was properly submitted to the jury as a question of fact. NB: *Chisholm* additionally *approved* a jury *instruction* that a *substitute offer* of the employer to work for a lesser compensation was *not to be considered in mitigation*, as the employee was not required to accept it. *Williams v. National Organization, Masters, etc.* (1956) 384 Pa. 413 [120 A.2d 896, 901 [13]]: “Even assuming that plaintiff ... could have obtained employment in ports other than ... where he resided, *legally* he was not compelled to do so in order to mitigate his damages.” (Italics added.)

[12]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.

[13]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 (see fn. 2, *ante*), 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. (See *Gonzales v. Internal. Assn. of Machinists*, *supra.*, 213 Cal.App.2d 817, 823-824; and fn. 5, *post.*)

[14]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. (See *Colvig* v. KSFO (1964) 224 Cal.App.2d 357, 364 [36 Cal.Rptr. 701]; *Dashew v. Dashew Business Machines, Inc.* (1963) 218 Cal.App.2d 711, 715 [32 Cal.Rptr. 682]; *Hatch v. Bush* (1963) 215 Cal.App.2d 692, 707 [30 Cal. Rptr. 397, 13 A.L.R.3d 503]; *Barry v. Rodgers* (1956) 141 Cal.App.2d 340, 342 [296 P.2d 898].)

[15]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.

[16]The judgment is affirmed.

McComb, J., Peters, J., Tobriner, J., Kaus, J. (Assigned by the Acting Chairman of the Judicial Council) and Roth, J., (Assigned by the Acting Chairman of the Judicial Council) concurred.

SULLIVAN, ACTING C. J., *DISSENTING*

[17]The basic question in this case is whether or not plaintiff acted reasonably in rejecting defendant's offer of alternate employment. The answer depends upon whether that offer (starring in “Big Country, Big Man”) was an offer of work that was substantially similar to her former employment (starring in “Bloomer Girl”) or of work that was of a different or inferior kind. To my mind this is a factual issue, which the trial court should not have determined on a motion for summary judgment. The majority have not only repeated this error but have compounded it by applying the rules governing mitigation of damages in the employer-employee context in a misleading fashion. Accordingly, I respectfully dissent.

[18]The familiar rule requiring a plaintiff in a tort or contract action to mitigate damages embodies notions of fairness and socially responsible behavior which are fundamental to our jurisprudence. Most broadly stated, it precludes the recovery of damages which, through the exercise of due diligence, could have been avoided. Thus, in essence, it is a rule requiring reasonable conduct in commercial affairs. This general principle governs the obligations of an employee after his employer has wrongfully repudiated or terminated the employment contract. Rather than permitting the employee

simply to remain idle during the balance of the contract period, the law requires him to make a reasonable effort to secure other employment.[xxix] He is not obliged, however, to seek or accept any and all types of work which may be available. Only work which is in the same field and which is of the same quality need be accepted.[xxx]

[19]Over the years the courts have employed various phrases to define the type of employment which the employee, upon his wrongful discharge, is under an obligation to accept. Thus in California alone it has been held that he must accept employment which is "substantially similar" (*Lewis v. Protective Security Life Ins. Co.* (1962) 208 Cal.App.2d 582, 584 [25 Cal.Rptr. 213]; *de la Falaise v. Gaumont-British Picture Corp.* (1940) 39 Cal.App.2d 461, 469 [103 P.2d 447]); "comparable employment" (*Erler v. Five Points Motors, Inc.* (1967) 249 Cal.App.2d 560, 562 [57 Cal.Rptr. 516]; *Harris v. Nat. Union etc. Cooks, Stewards* (1953) 116 Cal.App.2d 759, 761 [254 P.2d 673]); employment "in the same general line of the first employment" (*Rotter v. Stationers Corp.* (1960) 186 Cal.App.2d 170, 172 [8 Cal. Rptr. 690]); "equivalent to his prior position" (*De Angeles v. Roos Bros., Inc.* (1966) 244 Cal.App.2d 434, 443 [52 Cal.Rptr. 783]); "employment in a similar capacity" (*Silva v. McCoy* (1968) 259 Cal.App.2d 256, 260 [66 Cal.Rptr. 364]); employment which is "not ... of a different or inferior kind...." (*Gonzales v. Internat. Assn. of Machinists* (1963) 213 Cal.App.2d 817, 822 [29 Cal.Rptr. 190].)[xxxi]

[20]For reasons which are unexplained, the majority cite several of these cases yet select from among the various judicial formulations which they contain one particular phrase, "Not of a different or inferior kind," with which to analyze this case. I have discovered no historical or theoretical reason to adopt this phrase, which is simply a negative restatement of the affirmative standards set out in the above cases, as the exclusive standard. Indeed, its emergence is an example of the dubious phenomenon of the law responding not to rational judicial choice or changing

social conditions, but to unrecognized changes in the language of opinions or legal treatises.[xxxii] However, the phrase is a serviceable one and my concern is not with its use as the standard but rather with what I consider its distortion.

[21]The relevant language excuses acceptance only of employment which is of a *different kind. (Gonzales v. Internat. Assn. of Machinists*, *supra.*, 213 Cal.App.2d 817, 822; *Harris v. Nat. Union etc. Cooks, Stewards*, *supra.*, 116 Cal.App.2d 759, 761; *de la Falaise v. Gaumont-British Picture Corp.*, *supra.*, 39 Cal.App.2d 461, 469.) 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.

[22]Although the majority appear to hold that there was a difference "in kind" between the employment offered plaintiff in "Bloomer Girl" and that offered in "Big Country" (*ante*, at p. 183), an examination of the opinion makes crystal clear that the majority merely point out differences between the two *films* (an obvious circumstance) and then apodically assert that these constitute a difference in the *kind of employment*. The entire rationale of the majority boils down to this; that the "*mere circumstances*" that "Bloomer Girl" was to be a musical review while "Big Country" was a straight drama "demonstrates the difference in kind" since a female lead in a western is not "the equivalent of or substantially similar to" a lead in a musical. This is merely attempting to prove the proposition by repeating it. It shows that the vehicles for the display of the star's talents are different but it does not prove that her employment as a star in such vehicles is of necessity different *in kind* and either inferior or superior.

[23]I believe that the approach taken by the majority (a superficial listing of differences with no attempt to assess their significance) may subvert a valuable legal doctrine.[xxxiii] The inquiry in cases such as this should not be whether differences between the two jobs exist (there will always be differences) but whether the differences which are present are substantial enough to constitute differences in the *kind* of employment or, alternatively, whether they render the substitute work employment of an *inferior kind*.

[24]It seems to me that *this* inquiry involves, in the instant case at least, factual determinations which are improper on a motion for summary judgment. Resolving whether or not one job is substantially similar to another or whether, on the other hand, it is of a different or inferior kind, will often (as here) require a critical appraisal of the similarities and differences between them in light of the importance of these differences to the employee. This necessitates a weighing of the evidence, and it is precisely this undertaking which is forbidden on summary judgment. (*Garlock v. Cole* (1962) 199 Cal. App. 2d 11, 14 [18 Cal.Rptr. 393].)

[25]This is not to say that summary judgment would never be available in an action by an employee in which the employer raises the defense of failure to mitigate damages. No case has come to my attention, however, in which summary judgment has been granted on the issue of whether an employee was obliged to accept available alternate employment. Nevertheless, there may well be cases in which the substitute employment is so manifestly of a dissimilar or inferior sort, the declarations of the plaintiff so complete and those of the defendant so conclusionary and inadequate that no factual issues exist for which a trial is required. This, however, is not such a case.

[26]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.[xxxiv] 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."

[27]The declaration of Herman Citron, plaintiff's theatrical agent, alleges that prior to the formation of the "Bloomer Girl" contract he discussed with Richard Zanuck, defendant's vice president, the conditions under which plaintiff might be interested in doing "Big Country"; that it was Zanuck who informed him of Fox's decision to cancel production of "Bloomer Girl" and queried him as to plaintiff's continued interest in "Big Country"; that he informed Zanuck that plaintiff was shocked by the decision, had turned down other offers because of her commitment to defendant for "Bloomer Girl" and was not interested in "Big Country." It further alleges that "Bloomer Girl" was to have been a musical review which would have given plaintiff an opportunity to exhibit her talent as a dancer as well as an actress and that "Big Country" was a straight dramatic role; the former to have been produced in California, the latter in Australia. Citron's declaration concludes by stating that he has not received any payment from defendant for plaintiff under the "Bloomer Girl" contract.

[28]Benjamin Neuman's declaration states that he is plaintiff's attorney; that after receiving notice of defendant's breach he requested Citron to make every effort to obtain other suitable employment for plaintiff; that he (Neuman) rejected defendant's offer to settle for $400,000 and that he has not received any payment from defendant for plaintiff under the "Bloomer Girl" contract. It also sets forth correspondence

between Neuman and Fox which culminated in Fox's final rejection of plaintiff's demand for full payment.

[29]The plaintiff's declarations were of no assistance to the trial court in its effort to justify reaching this conclusion on summary judgment. Instead, it was forced to rely on judicial notice of the definitions of "motion picture," "screenplay" and "director" (Evid. Code, § 451, subd. (e)) and then on judicial notice of practices in the film industry which were purportedly of "common knowledge." (Evid. Code, § 451, subd. (f) or § 452, subd. (g).) This use of judicial notice was error. Evidence Code section 451, subdivision (e) was never intended to authorize resort to the dictionary to solve essentially factual questions which do not turn upon conventional linguistic usage. More important, however, the trial court's notice of "facts commonly known" violated Evidence Code section 455, subdivision (a).[xxxv] Before this section was enacted there were no procedural safeguards affording litigants an opportunity to be heard as to the propriety of taking judicial notice of a matter or as to the tenor of the matter to be noticed. Section 455 makes such an opportunity (which may be an element of due process, see Evid. Code, § 455, Law Revision Com. Comment (a)) mandatory and its provisions should be scrupulously adhered to. "[J]udicial notice can be a valuable tool in the adversary system for the lawyer as well as the court" (Kongsgaard, *Judicial Notice* (1966) 18 Hastings L.J. 117, 140) and its use is appropriate on motions for summary judgment. Its use in this case, however, to determine on summary judgment issues fundamental to the litigation without complying with statutory requirements of notice and hearing is a highly improper effort to "cut the Gordion knot of involved litigation." (*Silver Land & Dev. Co. v. California Land Title Co.* (1967) 248 Cal.App.2d 241, 242 [56 Cal.Rptr. 178].)

[30]The majority do not confront the trial court's misuse of judicial notice. They avoid this issue through the expedient of declaring that neither judicial notice nor expert opinion (such

as that contained in the declarations in opposition to the motion)[xxxvi] is necessary to reach the trial court's conclusion. *Something*, however, clearly *is* needed to support this conclusion. Nevertheless, the majority make no effort to justify the judgment through an examination of the plaintiff's declarations. Ignoring the obvious insufficiency of these declarations, the majority announce that "the deprivation or infringement of an employee's rights held under an original employment contract" changes the alternate employment offered or available into employment of an inferior kind.

[31]The second declaration is that of Richard Zanuck. It avers that he is Fox's vice president in charge of production; that he has final responsibility for casting decisions, that he is familiar with plaintiff's ability and previous artistic history; that the offer of employment for "Big Country" was in the same general line and comparable to that of "Bloomer Girl"; that plaintiff would not have suffered any detriment to her image or reputation by appearing in it; that elimination of director and script approval rights would not injure plaintiff; that plaintiff has appeared in dramatic and western roles previously and has not limited herself to musicals; and that Fox would have complied with the terms of its offer if plaintiff had accepted it.

[32]I cannot accept the proposition that an offer which eliminates *any* contract right, regardless of its significance, is, as a matter of law, an offer of employment of an inferior kind. Such an absolute rule seems no more sensible than the majority's earlier suggestion that the mere existence of differences between two jobs is sufficient to render them employment of different kinds. Application of such per se rules will severely undermine the principle of mitigation of damages in the employer-employee context.

[33]I remain convinced that the relevant question in such cases is whether or not a particular contract provision is so significant that its omission creates employment of an inferior kind. This question is, of course, intimately bound up in what

I consider the ultimate issue: whether or not the employee acted reasonably. This will generally involve a factual inquiry to ascertain the importance of the particular contract term and a process of weighing the absence of that term against the countervailing advantages of the alternate employment. In the typical case, this will mean that summary judgment must be withheld.

[34]In the instant case, there was nothing properly before the trial court by which the importance of the approval rights could be ascertained, much less evaluated. Thus, in order to grant the motion for summary judgment, the trial court misused judicial notice. In upholding the summary judgment, the majority here rely upon per se rules which distort the process of determining whether or not an employee is obliged to accept particular employment in mitigation of damages.

[35]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.

3.6.1 Discussion of Parker v. Twentieth Century-Fox

Would you expect that a promisee's "reasonable efforts to avoid loss" would include accepting an offer of substitute performance from the breaching party?

Is there any chance that accepting the breacher's offer could impair the promisee's right to prove a breach of contract?

Suppose that promisees were obliged to accept any offer in mitigation of damages without considering its source. Might such a rule encourage breaching promisors to make opportunistic offers calculated to be unattractive but sufficient to reduce the amount of damages recoverable for breach? Is there any evidence in *Parker* of this type of behavior?

The *Parker* court holds that wrongfully discharged employees need only accept "substantially similar" employment in mitigation of their losses. Why do courts limit the types of work that plaintiffs must accept? What competing concern makes avoidability doctrine an important source of incentives for workers who have suffered the breach of an employment contract?

4 Cost of Completion vs. Difference in Value

Recall that expectation damages are the default remedy for breach of contract. According to Restatement § 344, protecting the promisee's expectation interest requires an award of damages sufficient to "put [him] in as good a position as he would have been in had the contract been performed." But what exactly is required to achieve this objective? The cases that follow attempt to answer this question.

4.1 Principal Case – American Standard v. Schectman

American Standard, Inc. v. Schectman
Supreme Court of New York, Appellate Division
80 A.D.2d 318; 439 N.Y.S.2d 529 (1981)

HANCOCK, JR.

[1] Plaintiffs have recovered a judgment on a jury verdict of $90,000 against defendant for his failure to complete grading and to take out certain foundations and other subsurface structures to one foot below the grade line as promised. Whether the court should have charged the jury, as defendant Schectman requested, that the difference in value of plaintiffs' property with and without the promised performance was the measure of the damage is the main point in his appeal.[xxxvii] We hold that the request was properly denied and that the cost of completion—not the difference in value—was the proper measure. Finding no basis for reversal, we affirm.

[2] Until 1972, plaintiffs operated a pig iron manufacturing plant on land abutting the Niagara River in Tonawanda. On the 26-acre parcel were, in addition to various industrial and office buildings, a 60-ton blast furnace, large lifts, hoists and other equipment for transporting and storing ore, railroad tracks, cranes, diesel locomotives and sundry implements and devices used in the business. Since the 1870's plaintiffs' property, under several different owners, had been the site of

various industrial operations. Having decided to close the plant, plaintiffs on August 3, 1973 made a contract in which they agreed to convey the buildings and other structures and most of the equipment to defendant, a demolition and excavating contractor, in return for defendant's payment of $275,000 and his promise to remove the equipment, demolish the structures and grade the property as specified.

[3] We agree with Trial Term's interpretation of the contract as requiring defendant to remove all foundations, piers, headwalls, and other structures, including those under the surface and not visible and whether or not shown on the map attached to the contract, to a depth of approximately one foot below the specified grade lines.[xxxviii] The proof from plaintiffs' witnesses and the exhibits, showing a substantial deviation from the required grade lines and the existence above grade of walls, foundations and other structures, support the finding, implicit in the jury's verdict, that defendant failed to perform as agreed. Indeed, the testimony of defendant's witnesses and the position he has taken during his performance of the contract and throughout this litigation (which the trial court properly rejected), *viz.*, that the contract did not require him to remove all subsurface foundations, allow no other conclusion.

[4] We turn to defendant's argument that the court erred in rejecting his proof that plaintiffs suffered no loss by reason of the breach because it makes no difference in the value of the property whether the old foundations are at grade or one foot below grade and in denying his offer to show that plaintiffs succeeded in selling the property for $183,000—only $3,000 less than its full fair market value. By refusing this testimony and charging the jury that the cost of completion (estimated at $110,500 by plaintiffs' expert), not diminution in value of the property, was the measure of damage the court, defendant contends, has unjustly permitted plaintiffs to reap a windfall at his expense. Citing the definitive opinion of Judge Cardozo in *Jacob & Youngs v Kent* (230 NY 239), he maintains that the

facts present a case "of substantial performance" of the contract with omissions of "trivial or inappreciable importance" and that because the cost of completion was "grossly and unfairly out of proportion to the good to be attained," the proper measure of damage is diminution in value.

[5] The general rule of damages for breach of a construction contract is that the injured party may recover those damages which are the direct, natural and immediate consequence of the breach and which can reasonably be said to have been in the contemplation of the parties when the contract was made (see 13 NY Jur, Damages, §§ 46, 56; *Chamberlain v Parker*, 45 NY 569; *Hadley v Baxendale*, 9 Exch [Welsby, Hurlstone & Gordon] 341; Restatement, Contracts, § 346). In the usual case where the contractor's performance has been defective or incomplete, the reasonable cost of replacement or completion is the measure (see *Bellizzi v Huntley Estates*, 3 NY2d 112; *Spence v Ham*, 163 NY 220; *Condello v Stock*, 285 App Div 861, mod on other grounds 1 NY2d 831; *Along-The-Hudson Co. v Ayres*, 170 App Div 218; 13 NY Jur, Damages, § 56, p 502; Restatement, Contracts, § 346). When, however, there has been a substantial performance of the contract made in good faith but defects exist, the correction of which would result in economic waste, courts have measured the damages as the difference between the value of the property as constructed and the value if performance had been properly completed (see *Jacob & Youngs v Kent, supra; Droher & Sons v Toushin*, 250 Minn 490; Restatement, Contracts, § 346, subd [1], par [a], cl [ii], p 573; comment *b*, p 574; 13 NY Jur, Damages, § 58; Ann., 76 ALR2d 805, § 4, pp 812-815). *Jacob & Youngs* is illustrative. There, plaintiff, a contractor, had constructed a house for the defendant which was satisfactory in all respects save one: the wrought iron pipe installed for the plumbing was not of Reading manufacture, as specified in the contract, but of other brands of the same quality. Noting that the breach was unintentional and the consequences of

the omission trivial, and that the cost of replacing the pipe would be "grievously out of proportion" *(Jacob & Youngs v Kent, supra*, p 244) to the significance of the default, the court held the breach to be immaterial and the proper measure of damage to the owner to be not the cost of replacing the pipe but the nominal difference in value of the house with and without the Reading pipe.

[6] Not in all cases of claimed "economic waste" where the cost of completing performance of the contract would be large and out of proportion to the resultant benefit to the property have the courts adopted diminution in value as the measure of damage. Under the Restatement rule, the completion of the contract must involve "unreasonable economic waste" and the illustrative example given is that of a house built with pipe different in name but equal in quality to the brand stipulated in the contract as in *Jacob & Youngs v Kent* (230 NY 239, *supra)* (Restatement, Contracts, § 346, subd [1], par [a], cl [ii], p 573; Illustration No. 2, p 576). In *Groves v Wunder Co.* (205 Minn. 163), plaintiff had leased property and conveyed a gravel plant to defendant in exchange for a sum of money and for defendant's commitment to return the property to plaintiff at the end of the term at a specified grade -- a promise defendant failed to perform. Although the cost of the fill to complete the grading was $60,000 and the total value of the property, graded as specified in the contract, only $12,160 the court rejected the "diminution in value" rule, stating: "The owner's right to improve his property is not trammeled by its small value. It is his right to erect thereon structures which will reduce its value. If that be the result, it can be of no aid to any contractor who declines performance. As said long ago in Chamberlain v. Parker, 45 N.Y. 569, 572: 'A man may do what he will with his own, ... and if he chooses to erect a monument to his caprice or folly on his premises, and employs and pays another to do it, it does not lie with a defendant who has been so employed and paid for

building it, to say that his own performance would not be beneficial to the plaintiff.'" *(Groves v Wunder Co., supra*, p 168.)

[7] The "economic waste" of the type which calls for application of the "diminution in value" rule generally entails defects in construction which are irremediable or which may not be repaired without a substantial tearing down of the structure as in *Jacob & Youngs* (see *Bellizzi v Huntley Estates*, 3 NY2d 112, 115, *supra; Groves v Wunder Co., supra; Slugg Seed & Fertilizer v Paulson Lbr.*, 62 Wis 2d 220; Restatement, Contracts, § 346, subd [1], Illustration Nos. 2, 4, pp 576-577; Ann., 76 ALR2d 805, § 4, pp 812-815).

[8] Where, however, the breach is of a covenant which is only incidental to the main purpose of the contract and completion would be disproportionately costly, courts have applied the diminution in value measure even where no destruction of the work is entailed (see, e.g., *Peevyhouse v Garland Coal & Min. Co.*, 382 P2d 109 [Okla], *cert. denied*, 375 U.S. 906, holding [contrary to *Groves v Wunder Co., supra*] that diminution in value is the proper measure where defendant, the lessee of plaintiff's lands under a coal mining lease, failed to perform costly remedial and restorative work on the land at the termination of the lease. The court distinguished the "building and construction" cases and noted that the breach was of a covenant incidental to the main purpose of the contract which was the recovery of coal from the premises to the benefit of both parties; and see *Avery v Fredericksen & Westbrook*, 67 Cal App 2d 334).

[9] It is also a general rule in building and construction cases, at least under *Jacob & Youngs (supra)* in New York (see *Groves v Wunder Co., supra*; Ann., 76 ALR2d 805, § 6, pp 823-826), that a contractor who would ask the court to apply the diminution of value measure "as an instrument of justice" must not have breached the contract intentionally and must show substantial performance made in good faith *(Jacob & Youngs v Kent, supra*, pp 244, 245).

[10]In the case before us, plaintiffs chose to accept as part of the consideration for the promised conveyance of their valuable plant and machines to defendant his agreement to grade the property as specified and to remove the foundations, piers and other structures to a depth of one foot below grade to prepare the property for sale. It cannot be said that the grading and the removal of the structures were incidental to plaintiffs' purpose of "achieving a reasonably attractive vacant plot for resale" (cf. *Peevyhouse v Garland Coal & Min. Co., supra)*. Nor can defendant maintain that the damages which would naturally flow from his failure to do the grading and removal work and which could reasonably be said to have been in the contemplation of the parties when the contract was made would not be the reasonable cost of completion (see 13 NY Jur, Damages, §§ 46, 56; *Hadley v Baxendale*, 9 Exch [Welsby, Hurlstone & Gordon] 341, *supra)*. That the fulfillment of defendant's promise would (contrary to plaintiffs' apparent expectations) add little or nothing to the sale value of the property does not excuse the default.

[11]As in the hypothetical case, posed in *Chamberlain v Parker* (45 NY 569, *supra)* (cited in *Groves v Wunder Co.*, 205 Minn 163, *supra)*, of the man who "chooses to erect a monument to his caprice or folly on his premises, and employs and pays another to do it", it does not lie with defendant here who has received consideration for his promise to do the work "to say that his own performance would not be beneficial to the [plaintiffs]" *(Chamberlain v Parker, supra*, p 572).

[12]Defendant's completed performance would not have involved undoing what in good faith was done improperly but only doing what was promised and left undone (cf. *Jacob & Youngs v Kent*, 230 NY 239, *supra*; Restatement, Contracts, § 346, subd [1], Illustration No. 2, p 576). That the burdens of performance were heavier than anticipated and the cost of completion disproportionate to the end to be obtained does not, without more, alter the rule that the measure of plaintiffs' damage is the cost of completion. Disparity in relative

economic benefits is not the equivalent of "economic waste" which will invoke the rule in *Jacob & Youngs v Kent (supra)* (see *Groves v Wunder Co., supra)*. Moreover, faced with the jury's finding that the reasonable cost of removing the large concrete and stone walls and other structures extending above grade was $90,000, defendant can hardly assert that he has rendered substantial performance of the contract or that what he left unfinished was "of trivial or inappreciable importance" *(Jacob & Youngs v Kent, supra*, p 245). Finally, defendant, instead of attempting in good faith to complete the removal of the underground structures, contended that he was not obliged by the contract to do so and, thus, cannot claim to be a "transgressor whose default is unintentional and trivial [and who] may hope for mercy if he will offer atonement for his wrong" *(Jacob & Youngs v Kent, supra*, p 244). We conclude, therefore, that the proof pertaining to the value of plaintiffs' property was properly rejected and the jury correctly charged on damages.

[13]The judgment and order should be affirmed.

4.2 Principal Case – Peevyhouse v. Garland Coal & Mining Co.

Peevyhouse v. Garland Coal & Mining Co.
Supreme Court of Oklahoma
382 P.2d 109 (1962)

JACKSON, JUSTICE.

[1] 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.

[2] 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.

[3] 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 "stripmining" 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 $29,000.00. However, plaintiffs sued for only $25,000.00.

[4] 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.

[5] 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.

[6] 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."

[7] 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.

[8] It returned a verdict for plaintiffs for $5000.00—only a fraction of the "cost of performance," *but more than the total value of the farm even after the remedial work is done*.

[9] 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."

[10]It appears that this precise question has not heretofore been presented to this court. In *Ardizonne v. Archer*, 72 Okl. 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.

[11]Plaintiffs rely on *Groves v. John Wunder Co.*, 205 Minn. 163, 286 N.W. 235, 123 A.L.R. 502. In that case, the Minnesota court, in a substantially similar situation, adopted the "cost of performance" rule 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.

[12]It may be observed that *Groves v. John Wunder Co.*, *supra*, 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.

[13]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.

[14]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.

[15]In *Groves v. John Wunder Co.*, *supra*, in arriving at its conclusions, 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.

[16]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."

[17]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.

[18]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. The American Law Institute's RESTATEMENT OF THE LAW, CONTRACTS, Volume 1, Sections 346(1)(a)(i) and (ii) 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.

[19]On the other hand, in MCCORMICK, DAMAGES, Section 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. The same idea was expressed in *Jacob & Youngs, Inc. v. Kent*, 230 N.Y. 239, 129 N.E. 889, 23 A.L.R. 1429, as follows:

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.

[20]It thus appears that the prime consideration in the Restatement was "economic waste;" and that the prime consideration in MCCORMICK, DAMAGES, and in *Jacob & Youngs, Inc. v. Kent*, *supra*, was the relationship between the expense involved and the "end to be attained"—in other words, the "relative economic benefit."

[21]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).

[22]23 O.S.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 Sec. 96.

[23]An analogy may be drawn between the cited sections, and the provisions of 15 O.S.1961 §§ 214 and 215. These sections tend to render void any provisions of a contract which attempt to fix the amount of stipulated damages to be paid in case of a breach, except where it is impracticable or extremely difficult to determine the actual damages. This results in spite of the agreement of the parties, and the obvious and well known rationale is that insofar as they exceed the actual damages suffered, the stipulated damages amount to a penalty or forfeiture which the law does not favor.

[24]23 O.S.1961 §§ 96 and 97 have the same effect in the case now before us. *In spite of the agreement of the parties*, these sections 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."

[25]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.

[26]We believe the above holding is in conformity with the intention of the Legislature as expressed in the statutes mentioned, and in harmony with the better-reasoned cases from the other jurisdictions where analogous fact situations have been considered. 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.

[27]The above holding disposes of all of the arguments raised by the parties on appeal.

[28]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.

[29]We are asked by each party to modify the judgment in accordance with the respective theories advanced, and it is conceded that we have authority to do so. 12 O.S.1961 § 952; *Busboom v. Smith*, 199 Okl. 688, 191 P.2d 198; *Stumpf v. Stumpf*, 173 Okl. 1, 46 P.2d 315.

[30]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.

WELCH, DAVISON, HALLEY, AND JOHNSON, JJ., CONCUR.

WILLIAMS, C. J., BLACKBIRD, V. C. J., AND IRWIN AND BERRY, JJ., DISSENT.

IRWIN, JUSTICE (DISSENTING).

[31]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.

[32]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 wilful and not in good faith.

[33]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.

[34]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.

[35]Defendant received as consideration for the contract, its proportionate share of the coal produced and marketed and in addition thereto, the *right to use* plaintiffs' land in the furtherance of its mining operations.

[36]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.

[37]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.

[38]If a peculiar set of facts should exist where the above rule should be applied as the proper measure of damages, (and in my judgment those facts do not exist in the instant case) before such rule should be applied, consideration should be given to the benefits received or contracted for by the party who asserts the application of the rule.

[39]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.

[40]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.

[41]In *Goble v. Bell Oil & Gas Co.*, 97 Okl. 261, 223 P. 371, we held:

> Even though the contract contains harsh and burdensome terms which the court does not in all respects approve, it is the province of the parties in relation to lawful subject matter to fix their rights and obligations, and the

> court will give the contract effect according to its expressed provisions, unless it be shown by competent evidence proof that the written agreement as executed is the result of fraud, mistake, or accident.

[42]In *Cities Service Oil Co. v. Geolograph Co. Inc.*, 208 Okl. 179, 254 P.2d 775, we said:

> While we do not agree that the contract as presently written is an onerous one, we think the short answer is that the folly or wisdom of a contract is not for the court to pass on.

[43]In Great Western Oil & Gas Company v. Mitchell, Okl., 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.

[44]I am mindful of Title 23 O.S.1961 § 96, which provides that no person can recover a greater amount in damages for the breach of an obligation than he could have gained by the full performance thereof on both sides, except in cases not applicable herein. However, in my judgment, the above statutory provision is not applicable here.

[45]In my judgment, we should follow the case of *Groves v. John Wunder Company*, 205 Minn. 163, 286 N.W. 235, 123 A.L.R. 502, which defendant agrees "that the fact situation is apparently similar to the one in the case at bar", and where the Supreme Court of Minnesota held:

> The owner's or employer's damages for such a breach (i. e. breach hypothesized in 2d syllabus) are to be measured, not in respect to the value of the land to be improved, but by the reasonable cost of doing that which the

> contractor promised to do and which he left undone.

[46]The hypothesized breach referred to states that where the contractor's breach of a contract is willful, that is, in bad-faith, he is not entitled to any benefit of the equitable doctrine of substantial performance.

[47]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.

[48]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.

[49]I therefore respectfully dissent to the opinion promulgated by a majority of my associates.

[Although none of what follows is strictly necessary for understanding the issues in Peevyhouse, the court's discussion of the testimony at trial may give us more insight into the facts underlying plaintiffs' claim for damages. You may also find grounds to question the competence of plaintiffs' counsel in developing the record and presenting arguments at trial.]

Supplemental Opinion on Rehearing

Jackson, Justice.

[50] In a Petition for Rehearing, plaintiffs Peevyhouse have raised certain questions not presented in the original briefs on appeal.

[51] They insist that the trial court excluded evidence as to the total value of the premises concerned, and, in effect, that they have not had their 'day in court'. This argument arises by reason of the fact that their farm consists not merely of the 60 acres covered by the coal mining lease, but includes other lands as well.

[52] Plaintiffs originally pleaded two causes of action against the defendant mining company. The first one was for damages for breach of contract; the second one was for damages to the water well and home of plaintiffs, because of the use of excessively large charges of dynamite or blasting powder in close proximity to the home and well.

[53] Numbered paragraph 2 of plaintiffs' petition alleges that they own and live upon 60 acres of land which are specifically described. *This is the only land described in the petition, and there is no allegation as to the ownership or leasing of any other lands*.

[54] Page 4 of the transcript of evidence reveals that near the beginning of the trial, plaintiff Peevyhouse was asked a question concerning improvements he had made to his property. His answer was "For one thing I built a new home on the place in 1951, and along about that time I was building a pasture. And I would say *ninety percent of this 120 acres is in good grass*." (Emphasis supplied.) Mr.

Watts, defense counsel, then objected “to any testimony about the property, other than the 160 acres.” (It is obvious that he means “60” instead of “160.”) Further proceedings were as follows:

The Court: The objection will be sustained as to any other part. Go ahead

Mr. McCornell (attorney for plaintiffs): Comes now the plaintiff and dismisses the second cause of action without prejudice.

It thus appears that plaintiffs made no complaint as to the court's exclusion of evidence concerning lands other than the 60 acres described in their petition.

[55] Pages 7 and 8 of the transcript show that later during direct examination of Mr. Peevyhouse, the following occurred:

Q. (By Mr. McConnell) Now, Mr. Peevyhouse, I ask you to step down here and I ask you if you are familiar with this sketch or drawing?

…

A. Yes. I've got about 40 acres here, and here would be 20, and there would be 20 on this sketch. And I've got leased land lying in here, 80 acres.

Mr. Watts: If your Honor please, I object to anything except the 60 acres involved in this lawsuit.

The Court: Sustained.

Q. (By Mr. McConnell) Will you point out to the jury, the boundary line shown of your property?

….

A. That blue is where the water is actually standing at the present time. Up until a short time ago this area here came over that far. And this spring all of it would run, come in here out this way and through here, spreading over this land and all below it. And at the present time this is washed out here.

Mr. Watts: If your Honor please, I object to that as not the proper measure of damages.

The Court: The objection will be sustained.

This testimony of Mr. Peevyhouse is difficult for us to follow, even with the exhibits in the case before us. However, no complaint was made by plaintiffs, or any suggestion that the court was in error in excluding this testimony.

[56] The defendant offered the testimony of five witnesses in the trial court; four of them testified as to "diminution in value." They were not cross examined by plaintiffs.

[57] In their motion for new trial, plaintiffs did not complain that they had been prevented from offering evidence as to the diminution in value of their lands; on the contrary, they affirmatively complained of the trial court's action in admitting evidence of the *defendant* on that point.

[58] In the original brief of plaintiffs in error (Peevyhouse) filed in this court there appears the following language at page 4:

…Near the outset of the trial plaintiffs dismissed their second cause of action without prejudice: further, it was stipulated…. It was further stipulated that the *only issue remaining in the lawsuit* was the proof and *measure of damages* to which plaintiffs were entitled…. (Emphasis supplied.)

In the answer brief of Garland Coal & Mining Co., at page 3, there appears the following language:

Defendant offered evidence that the total value of the property involved before the mining operation would be $60.00 per acre, and $11.00 per acre after the mining operation (60 acres at $49.00 per acre is $2940.00). Other evidence was that the property was worth $5.00 to $15.00 per acre after the mining, but before the repairs; and would be worth an increase of $2.00 to $5.00 per acre after the repairs had been made (60 acres at $5.00 per acre is $300.00) (Tr. 96-97, 135, 137-138, 138-141, 143-145, 156, 158).

At page 18 of the same brief there is another statement to the effect that the 'amount of diminution in value of the land' was $300.00.

[59] About two months after the answer brief was filed in this court, plaintiffs filed a reply brief. The reply brief makes no reference at all to the language of the answer brief above quoted and *does not deny that the diminution in value shown by the record amounts to $300.00*. On the contrary, it contains the following language at page 5:

…Plaintiffs in error pointed out in their initial brief that this evidence concerning land values was objectionable as being incompetent and refused to cross-examine or offer rebuttal for the reason that they did not choose to waive their objections to the competency of the evidence by disproving defendant in error's allegations as to land values. We strongly urged at the trial below, and still do, that market value of the land has no application….

[60] Our extended reference to the pleadings, testimony and prior briefs in this case has not been solely for the purpose of showing that plaintiffs failed to complain of the court's rulings. Our purpose, rather, has been to demonstrate the plan and theory upon which plaintiffs tried their case below, and upon which they argued it in the prior briefs on appeal.

[61] The whole record in this case justifies the conclusion that plaintiffs tried their case upon the theory that the "cost of performance" would be the sole measure of damages and that they would recognize no other. In view of the whole record in this case and the original briefs on appeal, we conclude that they so tried it *with notice* that defendant would contend for the "diminution in value" rule. The testimony to which they specifically refer in the petition for rehearing shows that the trial court properly excluded defendant's evidence concerning lands other than the 60 acres described in the petition because such evidence was *not within the scope of the pleadings*. At no time did plaintiffs ask permission to amend their petition, either with or without prejudice to trial, so as to describe *all* of the lands they own or lease, and no evidence was admitted which could broaden the scope of the petition.

[62] Plaintiffs' petition described 60 acres of land only; plaintiffs offered no evidence on the question of "diminution in value" and

objected to similar evidence offered by the defendant; their motion for new trial contained no allegation that they had been prevented from offering evidence on this question; in their reply brief they did not controvert the allegation in defendant's answer brief that the record showed a "diminution in value" of only $300.00; and in view of the stipulation they admittedly made in the trial court, their statement in petition for rehearing that the court's instructions on the measure of damages came as a "complete surprise" and "did not afford them the opportunity to prepare and introduce evidence under the 'diminution in value' rule" is not supported by the record.

[63] We think plaintiffs' present position is that of a plaintiff in any damage suit who has failed to prove his damages-opposed by a defendant who has proved plaintiff's damages; and that plaintiffs' complaint that the record does not show the total "diminution in value" to their lands comes too late. It is well settled that a party will not be permitted to change his theory of the case upon appeal. *Knox v. Eason Oil Co.*, 190 Okl. 627, 126 P.2d 247.

[64] Also, plaintiffs' expressed fear that by introducing evidence on the question of "diminution in value" they would have waived their objection to similar evidence by defendant was not justified. *Vogel v. Fisher et al.*, 203 Okl. 657, 225 P.2d 346; 53 Am. Jur. Trial § 144.

[65] It is suggested in a brief of amici curiae that our decision in this case has resulted in an impairment of the obligation of the contract of the parties, in violation of Article 1, Section 10, of the Constitution of the United States, and in that connection the only case cited is *Sturges v. Crowninshield*, 4 Wheat 122, 17 U.S. 1229 (1819). In their brief, amici curiae quote language from the Lawyer's Edition notes of Mr. Stephen K. Williams, in which he summarized the "points and authorities" of one of the counsel appearing before the U. S. Supreme Court.

[66] *Sturges v. Crowninshield* was an early case in which the Supreme Court considered the power of a state to enact bankruptcy laws, and the extent, if any, to which such power is limited by Article 1, Section 10 of the Constitution. The contracts concerned

consisted of promissory notes executed in March, 1811, and the bankruptcy law under which the promisor claimed a discharge was not enacted until April 3, 1811. In a memorable opinion written by Chief Justice Marshall, the court held that insofar as the bankruptcy law purported to discharge the obligations of contracts executed *before its enactment*, it was unconstitutional and void.

[67] The same situation does not exist here. 23 O.S.1961 §§ 96 and 97, cited in our original opinion, were a part of the Revised Laws of 1910 (R.L.1910) Sections 2889 and 2890) and have been in force in this state, in unchanged form, since that codification was adopted by the legislature in 1911. The lease contract concerned in the case now before us was not executed until 1954.

[68] Nor do we agree that our decision itself (as opposed to the statutes cited therein as controlling) impairs the obligations of the contract concerned. It may be conceded that at one time there was respectable authority for the proposition that the "contract" clause was violated by a judicial decision which overruled prior decisions, upon the strength of which contract rights had been acquired. In this connection, it should be noted that our decision overrules no prior holdings of this court upon which the contracting parties could be said to have relied. Even if it did,

… it is now definitely and authoritatively settled that such prohibition in federal and state constitutions relate to legislative action and not to judicial decisions. Thus, they do not apply to the decision of a state court, where such decision does not expressly, or by necessary implication, give effect to a subsequent law of the state whereby the obligation of the contract is impaired….

16 C.J.S. Constitutional Law § 280. To the same effect, see 12 Am. Jur. Constitutional Law § 398.

[69] Our decision herein overrules no prior holdings of this court, and it does not give effect to a *subsequent* law of this state. It therefore cannot be said to impair the obligations of the contract of the parties here concerned.

[70] The petition for rehearing is denied.

Halley, V. C. J., and Welch, Davison and Johnson, JJ., concur.

Blackbird, C. J., and Williams, Irwin and Berry, JJ., dissent.

4.2.1 The Story of *Peevyhouse*

The *Peevyhouse* decision has not fared well in the court of academic opinion. In a remarkably thorough historical account of the case, Professor Judith Maute sharply challenges the Oklahoma Supreme Court's conclusion that the agreement to restore the Peevyhouse farm was "merely incidental" to the main purpose of the contract.

> From the Peevyhouses' perspective, obtaining the promised remedial work was essential. Having observed the effects of strip-mining under the standard arrangement, they agreed to forego immediate payment of $3000 in consideration for Garland's promises of basic reclamation. The leased acreage was part of their homestead estate and connected to the land on which they lived but refused to lease. When placed against this backdrop, it is clear that the Peevyhouses highly valued the future utility of the leased land. These fundamental facts relate to their main purpose, as evidence of the express bargained-for-exchange, with payment of separate valuable consideration for remedial provisions….
>
> Willie and Lucille still live on the land located outside of Stigler. The land they leased to Garland has changed little from when the mining stopped more than thirty-five years ago. About half of the leased acreage remains unusable.

Judith Maute, Peevyhouse v. Garland Coal & Mining Co. *Revisited: The Ballad of Willie and Lucille*, 89 NW. L. REV. 1341, 1413, 1404 (1995) (The article's 146 pages include photos, diagrams and poetry, among other curiosities.).

Other commentators have expressed similar views about the case:

> When people enter into contracts, they also may be motivated by non-monetary considerations. The end to be achieved by performance may be desired in and of itself, not as a means to an increase in wealth measured by conventional methods of valuation. Consider the well-known case of *Peevyhouse v. Garland Coal & Mining Co.* …. If the land was important to them as a home as well as a source of income, the loss caused them by breach could not be measured solely by a reduction in market value. Any economic analysis that assigns no value to their love of home or treats the promise to restore the land as merely instrumental to protecting the market value is incapable of measuring the true costs and benefits of breach.

Peter Linzer, On the Amorality of Contract Remedies—Efficiency, Equity, and the Second Restatement, 81 COLUM. L. REV. 111, 117 (1981).

4.2.2 Rock Island Improvement Company v. Sexton

Criticism of *Peevyhouse* has not been limited to ivory tower academics. In *Rock Island Improvement Company v. Sexton*, 698 F.2d 1075 (10th Cir. 1983), a panel of the United States Court of Appeals for the Tenth Circuit opined that they were "convinced that the Oklahoma Supreme Court would no longer apply the rule it established in *Peevyhouse* in 1963 if it had the instant dispute before it …. Although we are bound by decisions of a state supreme court in diversity cases, we need not adhere to a decision if we think it no longer would be followed." *Id.* at 1078.

It took more than a decade for the Oklahoma Supreme Court to respond, but in *Schneberger v. Apache Corp.*, 890 P.2d 847 (Okla. 1995), that court decisively rejected *Rock Island* and reaffirmed its *Peevyhouse* holding. The Tenth Circuit had "misinterpreted" Oklahoma law, and the Oklahoma Supreme Court asserted that the "essence of the *Peevyhouse* holding—to award diminution in value rather than cost of performance—has been consistently adhered to in cases giving rise to temporary and permanent injuries to property." *Id.* at 851.

4.2.3 The Restatement (Second) on Cost vs. Value

Although the Restatement does not speak directly to the situation in *American Standard* and *Peevyhouse*, § 347 provides that the loss in value of performance caused by a breach is ordinarily the proper measure of the promisee's expectation interest. Section 348 offers "alternatives to loss in value of performance" for specific situations. Most nearly relevant to the issues we have been addressing is the following subsection of § 348:

> (2) If a breach results in defective or unfinished construction and the loss in value to the injured party is not proved with sufficient certainty, he may recover damages based on
>
> (a) the diminution in the market price of the property caused by the breach, or
>
> (b) the reasonable cost of completing performance or of remedying the defects if that cost is not clearly disproportionate to the probable loss in value to him.

Thus, subsection 2(a) specifies the remedy adopted in *Peevyhouse* and subsection 2(b) includes the limitation that caused the Oklahoma Supreme Court to reject a cost-of-performance measure in that case.

4.2.4 Discussion of American Standard v. Schectman and Peevyhouse v. Garland Coal

Consider whether it is the facts of these cases or the applicable legal standards that produce diametrically opposite results in *American Standard* and *Peevyhouse*. One possible explanation for the ruling in *Peevyhouse* is that the court wishes to avoid "economic waste." As the court explains:

> 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.

Thus, one might argue that to award the cost of performance in cases such as these will cause economic waste.

Suppose for the sake of discussion that in both *American Standard* and *Peevyhouse* the cost of completing the contractually specified grading work far exceeds its value to the landowner. Can you think of any reason to doubt that ordering Garland Coal or Schectman to perform or pay damages equal to the cost of performing will cause any economic waste?

Conversely one might object to a value of performance measure in cases such as these on the ground that the landowner has already paid for the cost of restoration in the original contract price. But consider how that price is likely to vary according to whether courts tend to award cost of performance or value of performance damages. If the price depends on the choice of legal rule, can we infer from the original contract prices in these cases anything about which rule is best?

Now consider the possibility that both cases were wrongly decided.

What did American Standard receive as a result of the remedy awarded in that case? What exactly was American Standard seeking under the express terms of the contract? Is it possible that the promisor's breach was an efficient response to unforeseen difficulties it encountered while removing the subsurface foundations? If so, could a cost of performance measure potentially impede efficient breach?

What do the Peevyhouses receive under the Oklahoma Supreme Court's ruling? What did they seek from this contract with Garland Coal? Are there any terms in the agreement that could support the court's conclusion that the restoration provisions were "merely incidental"? How would you advise landowners like the Peevyhouses to protect themselves in the future?

Is there any way to reconcile our desire to protect fully a promisor's expectation interest with some courts' evident concern about overcompensation?

5 Liquidated Damages

We conclude our study of contracts with the surprisingly stringent rules restricting the use of liquidated damages. Both the UCC and the Restatement (Second) of Contracts permit parties to specify contractually the damages recoverable for breach. However, the relevant sections also impose significant constraints. Liquidated damages become an unenforceable "penalty" unless they satisfy a doctrinal test that involves two broad inquiries. First, the clause must specify an amount that is a reasonable estimate at the time of contracting of the likely damages resulting from breach. Second, the party seeking enforcement of the clause must establish a need for estimation such as uncertainty about the likely loss or anticipated difficulty proving the loss.

Here is what the Restatement has to say on the subject:

> **§ 356. Liquidated Damages and Penalties**
>
> (1) Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty.
>
> (2) A term in a bond providing for an amount of money as a penalty for non-occurrence of the condition of the bond is unenforceable on grounds of public policy to the extent that the amount exceeds the loss caused by such non-occurrence.
>
> Comment:
>
> a. *Liquidated damages or penalty*. The parties to a contract may effectively provide in advance the

damages that are to be payable in the event of breach as long as the provision does not disregard the principle of compensation. The enforcement of such provisions for liquidated damages saves the time of courts, juries, parties and witnesses and reduces the expense of litigation. This is especially important if the amount in controversy is small. However, the parties to a contract are not free to provide a penalty for its breach. The central objective behind the system of contract remedies is compensatory, not punitive. Punishment of a promisor for having broken his promise has no justification on either economic or other grounds and a term providing such a penalty is unenforceable on grounds of public policy. The rest of the agreement remains enforceable, however, under the rule stated in § 184(1), and the remedies for breach are determined by the rules stated in this Chapter. A term that fixes an unreasonably small amount as damages may be unenforceable as unconscionable. See § 208. As to the liquidation of damages and modification or limitation of remedies in contracts of sale, see Uniform Commercial Code §§ 2-718, 2-719.

b. *Test of penalty*. Under the test stated in Subsection (1), two factors combine in determining whether an amount of money fixed as damages is so unreasonably large as to be a penalty. The first factor is the anticipated or actual loss caused by the breach. The amount fixed is reasonable to the extent that it approximates the actual loss that has resulted from the particular breach, even though it may not approximate the loss that might have been anticipated under other possible breaches. Furthermore, the amount fixed is reasonable to the extent that it approximates the loss anticipated at the time of the making of the contract, even though it may not approximate the actual loss. The second factor is the difficulty of proof of loss. The greater the difficulty either of proving that loss has occurred or of establishing its amount with the requisite certainty (see § 351), the easier it is to show that the amount fixed is reasonable. To the extent that there is uncertainty as to the harm, the estimate of the court or jury may not accord with the principle of compensation any more than does the advance estimate of the parties. A determination whether the amount fixed is a penalty turns on a combination of these two factors. If the difficulty of proof of loss is great, considerable latitude is allowed in the approximation of anticipated or actual harm. If, on the other hand, the difficulty of proof of loss is slight, less latitude is allowed in that approximation. If, to take an extreme case, it is clear that no loss at all has occurred, a provision fixing a substantial sum as damages is unenforceable.

c. *Disguised penalties*. Under the rule stated in this Section, the validity of a term providing for damages depends on the effect of that term as interpreted according to the rules stated in Chapter 9. Neither the parties' actual intention as to its validity nor their characterization of the term as one for liquidated damages or a penalty is significant in determining whether the term is valid. Sometimes parties attempt to disguise a provision for a penalty by using language that purports to make payment of the amount an alternative performance under the contract, that purports to offer a discount for prompt performance, or that purports to place a valuation on property to be delivered. Although the parties may in good faith contract for alternative performances and fix discounts or valuations, a court will look to the substance of the agreement to determine whether this is the case or whether the parties have attempted to disguise a provision for a penalty that is unenforceable under this Section. In determining whether a contract is one for alternative performances, the relative value of the alternatives may be decisive.

d. *Related types of provisions*. This Section does not purport to cover the wide variety of provisions used by parties to control the remedies available to them for breach of contract. A term that fixes as damages an amount that is unreasonably small does not come within the rule stated in this Section, but a court may refuse to enforce it as unconscionable under the rule stated in § 208. A mere recital of the harm that may occur as a result of a breach of contract does not come within the rule stated in this Section, but may increase damages by making that harm foreseeable under the rule stated § 351. As to the effect of a contract provision on the right to equitable relief, see Comment a to § 359. As to the effect of a term requiring the occurrence of a condition where forfeiture would result, see § 229. Although attorneys' fees are not generally awarded to the winning party, if the parties provide for the award of such fees the court will award a sum that it considers to be reasonable. If, however, the parties specify the amount of such fees, the provision is subject to the test stated in this Section.

e. *Penalties in bonds*. Bonds often fix a flat sum as a penalty for non-occurrence of the condition of the bond. A term providing for a penalty is not unenforceable in its entirety but only to the extent that it exceeds the loss caused by the non-occurrence of the condition.

The parallel provisions of the Uniform Commercial Code follow:

§ 2-718 Liquidation or Limitation of Damages; Deposits.

1) Damages for breach by either party may be liquidated in the agreement but only at an amount

> which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

In the cases that follow, see if you can discern the underlying policy reasons for courts' evident reluctance to enforce contractually specified damages.

5.1 Principal Case – Lake River Corp. v. Carborundum Co.

Lake River Corp. v. Carborundum Co.
United States Court of Appeals for the Seventh Circuit
769 F.2d 1284 (1985)

POSNER, CIRCUIT JUDGE.

[1] 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.

[2] 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.

[3] 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.

[4] If Carborundum had shipped the full minimum quantity that it guaranteed, it would have owed Lake River roughly $533,000 under the contract.

[5] 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.

[6] 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.

[7] 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 theory of the counterclaim is that the impounding was a conversion, and not as Lake River contends the assertion of a lien. The district judge, after a bench trial, gave judgment for both parties. Carborundum ended up roughly $42,000 to the good: $269,000 + $31,000-$241,000-$17,000, the last figure representing prejudgment interest on Lake River's damages. (We have rounded off all dollar figures to the nearest thousand.) Both parties have appealed.

[8] The only issue that is not one of damages is whether Lake River had a valid lien on the bagged Ferro Carbo that it refused to ship to Carborundum's customers—that, indeed, it holds in its warehouse to this day. Although Ferro Carbo does not deteriorate with age, the domestic steel industry remains in the doldrums and the product is worth less than it was in 1982 when Lake River first withheld it. If Lake River did not have a valid lien on the product, then it converted it, and must pay Carborundum the $269,000 that the Ferro Carbo was worth back then.

[9] It might seem that if the minimum-guarantee clause was a penalty clause and hence unenforceable, the lien could not be valid, and therefore that we should discuss the penalty issue first. But this is not correct. If the contractual specification of damages is invalid, Lake River still is entitled to any actual damages caused by Carborundum's breach of contract in failing to deliver the minimum amount of Ferro Carbo called for by the contract. The issue is whether an entitlement to damages, large or small, entitles the victim of the breach to assert a lien on goods that are in its possession though they belong to the other party.

[10]Lake River has not been very specific about the type of lien it asserts. We think it best described as a form of artisan's lien, the "lien of the bailee, who does work upon or adds materials to chattels...." Restatement of Security § 61, comment on clause (a), at p. 165 (1941). Lake River was the bailee of the Ferro Carbo that Carborundum delivered to it, and it did work on the Ferro Carbo—bagging it, and also storing it (storage is a service, too). If Carborundum had refused to pay for the services that Lake River performed on the Ferro Carbo delivered to it, then Lake River would have had a lien on the Ferro Carbo in its possession, to coerce payment. Cf. *National Bank of Joliet v. Bergeron Cadillac, Inc.,* 66 Ill.2d 140, 143-44, 5 Ill. Dec. 588, 589, 361 N.E.2d 1116, 1117 (1977). But in fact, when Lake River impounded the bagged Ferro Carbo, Carborundum had paid in full for all bagging and storage services that Lake River had performed on Ferro Carbo shipped to it by Carborundum. The purpose of impounding was to put pressure on Carborundum to pay for services not performed, Carborundum having failed to ship the Ferro Carbo on which those services would have been performed.

[11]Unlike a contractor who, having done the work contracted for without having been paid, may find himself in a box, owing his employees or suppliers money he does not have—money he was counting on from his customer—Lake River was the victim of a breach of a portion of the contract that remained entirely unexecuted on either side. Carborundum had not shipped the other 10,500 tons, as promised; but on the other hand Lake River had not had to bag those 10,500 tons, as it had promised. It is not as if Lake River had bagged those tons, incurring heavy costs that it expected to recoup from Carborundum, and then Carborundum had said, "Sorry, we won't pay you; go ahead and sue us."

[12]A lien is strong medicine; it clogs up markets, as the facts of this case show. Its purpose is to provide an effective self-

help remedy for one who has done work in expectation of payment and then is not paid. The vulnerable position of such a person gives rise to "the artisan's privilege of holding the balance for *work done in the past.*" *United States v. Toys of the World Club, Inc.,* 288 F.2d 89, 94 (2d Cir.1961) (Friendly, J.) (emphasis added). A lien is thus a device for preventing unjust enrichment—not for forcing the other party to accede to your view of a contract dispute. "The right to retain possession of the property to enforce a possessory lien continues until such time as the charges for such materials, labor and services are paid." *Bull v. Mitchell,* 448 N.E.2d 1016, 1019 (Ill. App. 1983); cf. Ill.Rev.Stat. ch. 82, § 40. Since here the charges were paid before the lien was asserted, the lien was no good.

[13]Lake River tries to compare its position to that of a conventional lien creditor by pointing out that it made itself particularly vulnerable to a breach of contract by buying specialized equipment at Carborundum's insistence, to the tune of $89,000, before performance under the contract began. It says it insisted on the minimum guarantee in order to be sure of being able to amortize this equipment over a large enough output of bagging services to make the investment worthwhile. But the equipment was not completely useless for other contracts—Lake River having in fact used it for another contract; it was not the major cost of fulfilling the contract; and Lake River received almost $300,000 during the term of the contract, thus enabling it to amortize much of the cost of the special equipment. Although Lake River may have lost money on the contract (but as yet there is no proof it did), it was not in the necessitous position of a contractor who completes his performance without receiving a dime and then is told by his customer to sue for the price. The recognition of a lien in such a case is based on policies akin to those behind the rule that a contract modification procured by duress will not be enforced. See, e.g., *Selmer Co. v. Blakeslee-Midwest Co.,* 704 F.2d

924 (7th Cir.1983). When as a practical matter the legal remedy may be inadequate because it operates too slowly, self-help is allowed. But we can find no case recognizing a lien on facts like these, no ground for thinking that the Illinois Supreme Court would be the first court to recognize such a lien if this case were presented to it, and no reason to believe that the recognition of such a lien would be a good thing. It would impede the marketability of goods without responding to any urgent need of creditors.

[14]*Conrow v. Little,* 22 N.E. 346, 347 (N.Y. 1889), on which Lake River relies heavily because the lien allowed in that case extended to "money expended in the preparation of instrumentalities," is not in point. The plaintiffs, dealers in paper, had made extensive deliveries to the defendants for which they had received no payment. See *id.* at 390-91, 22 N.E. at 346. If Lake River had bagged several thousand tons of Ferro Carbo without being paid anything, it would have had a lien on the Ferro Carbo; and maybe—if *Conrow* is good law in Illinois, a question we need not try to answer—the lien would have included not only the contract price for the Ferro Carbo that Lake River had bagged but also the unreimbursed, unsalvageable cost of the special bagging system that Lake River had installed. But that is not this case. Carborundum was fully paid up and Lake River has made no effort to show how much if any money it stood to lose because the bagging system was not fully amortized. The only purpose of the lien was to collect damages which would have been unrelated to—and certainly exceeded—the investment in the bagging system.

[15]It is no answer that the bagging system should be presumed to have been amortized equally over the life of the contract, and therefore to have been only half amortized when Carborundum broke the contract. Amortization is an accounting device; it need not reflect cash flows. There is no evidence that when the contract was broken, Lake River was out of pocket a cent in respect of the bagging system,

especially when we consider that the bagging system was still usable, and was used to fulfill another contract.

[16]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.

[17]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.

[18]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.

[19]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. *See, e.g.*, *Bauer v. Sawyer,* 134 N.E.2d 329, 333-34 (Ill. 1956); *Stride v. 120 West Madison Bldg. Corp.,* 477 N.E.2d 1318, 1321 (Ill. App. 1985); *Builder's Concrete Co. v. Fred Faubel & Sons, Inc.,* 373

N.E.2d 863, 869 (Ill. App. 1978). 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. *See, e.g.*, *M.I.G. Investments, Inc. v. Marsala,* 414 N.E.2d 1381, 1386 (Ill. App. 1981).

[20]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, *Weiss v. United States Fidelity & Guaranty Co.,* 132 N.E. 749, 751 (Ill. 1921); *M.I.G. Investments, Inc. v. Marsala, supra,* 414 N.E.2d 1381, 1386, and unlike some courts of appeals we do not treat a determination by a federal district judge of an issue of state law as if it were a finding of fact, and reverse only if persuaded that clear error has occurred, though we give his determination respectful consideration. See, e.g., *Morin Bldg. Products Co. v. Baystone Construction, Inc.,* 717 F.2d 413, 416-17 (7th Cir.1983); *In re Air Crash Disaster Near Chicago,* 701 F.2d 1189, 1195 (7th Cir.1983); 19 WRIGHT, MILLER & COOPER, FEDERAL PRACTICE AND PROCEDURE § 4507, at pp. 106-110 (1982).

[21]Mindful that Illinois courts resolve doubtful cases in favor of classification as a penalty, see, e.g., *Stride v. 120 West Madison Bldg. Corp., supra,* 477 N.E.2d at 1321; *Pick Fisheries, Inc. v. Burns Electronic Security Services, Inc.,* 342 N.E.2d 105, 108 (Ill. App. 1976), 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 *M.I.G. Investments, Inc. v. Marsala, supra,* 414 N.E.2d at 1386; cf. *Arduini v. Board of Educ.,* 418 N.E.2d 104, 109-10 (Ill. App. 1981), *rev'd on other grounds*, 441 N.E.2d 73 (Ill. 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.

[22]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.

[23]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.

[24]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.

[25]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.

[26]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. See *Northwest Collectors, Inc. v. Enders,* 446 P.2d 200, 206 (Wash. 1968).

[27]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.

[28]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.

[29]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,* 464 A.2d 546, 558 n. 8 (Pa. Comm.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.

[30]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.

[31]Two damage issues remain. The first concerns Carborundum's expenses of delivering bagged Ferro Carbo to its customers to replace that impounded by Lake River. The district judge gave Carborundum the full market value of the bagged Ferro Carbo. Lake River argues that it should not have to pay for Carborundum's expense of selling additional Ferro Carbo—additional in the sense that Carborundum is being given credit for the full retail value of the product that Lake River withheld. To explain, suppose that Carborundum had an order for $1,000 worth of bagged Ferro Carbo, which Lake River was supposed to deliver; and because it refused, Carborundum incurred a transportation cost of $100 to make a substitute shipment of bagged Ferro Carbo to the customer. Carborundum would still get $1,000 from the customer, and if that price covered the transportation cost it would still make a profit. In what sense, therefore, is that cost a separate item of damage, of loss? On all Ferro Carbo (related to this case) sold by Carborundum in the Midwest, Carborundum received the full market price, either from its customers in the case of Ferro Carbo actually delivered to them, or from Lake River in the case of the Ferro Carbo that Lake River refused to deliver. Having received a price designed to cover all expenses of sale, a seller cannot also get an additional damage award for any of those expenses.

[32]If, however, the additional Ferro Carbo that Carborundum delivered to its midwestern customers in substitution for Ferro Carbo previously delivered to, and impounded by, Lake River would have been sold in the East at the same price but lower cost, Carborundum would have had an additional loss, in the form of reduced profits, for which it could recover additional damages. But it made no

effort to prove such a loss. Maybe it had no unsatisfied eastern customers, and expanded rather than shifted output to fulfill its midwestern customers' demand. The damages on the counterclaim must be refigured also.

[33]Finally, Lake River argues that Carborundum failed to mitigate its damages by accepting Lake River's offer to deliver the bagged product and place the proceeds in escrow. But a converter is not entitled to retain the proceeds of the conversion even temporarily. Lake River had an opportunity to limit its exposure by selling the bagged product on Carborundum's account and deducting what it claimed was due it on its "lien." Its failure to follow this course reinforces our conclusion that the assertion of the lien was a naked attempt to hold Carborundum hostage to Lake River's view—an erroneous view, as it has turned out—of the enforceability of the damage formula in the contract.

[34]The judgment of the district court is affirmed in part and reversed in part, and the case is returned to that court to redetermine both parties' damages in accordance with the principles in this opinion. The parties may present additional evidence on remand, and shall bear their own costs in this court. Circuit Rule 18 shall not apply on remand.

5.1.1 Discussion of Lake River v. Carborundum

What is it about the clause in *Lake River* that makes it unenforceable?

Does Judge Posner's analysis perhaps call into question the enforceability of gas pipeline "take or pay" clauses?

5.2 Principal Case – C & H Sugar Co. v. Sun Ship

California and Hawaiian Sugar Co. v. Sun Ship, Inc.

United States Court of Appeals for the Ninth Circuit
794 F.2d 1433 (1986)

NOONAN, CIRCUIT JUDGE.

[1] Jurisdiction in this case is based on the diversity of citizenship of California and Hawaiian Sugar Company (C and H), a California corporation; Sun Ship, Inc. (Sun), a

Pennsylvania corporation; and Halter Marine, Inc. (Halter), a Louisiana corporation. Interpreting a contract which provides for construction by the law of Pennsylvania, we apply Pennsylvania law. The appeal is from a judgment of the district court in favor of C and H and Halter on the main issues. Reviewing the district court's interpretation of the contract anew as a matter of law and respecting the findings of fact of the district court when not clearly erroneous, we affirm the judgment in all respects.

BACKGROUND

[2] C and H is an agricultural cooperative owned by fourteen sugar plantations in Hawaii. Its business consists in transporting raw sugar—the crushed cane in the form of coarse brown crystal—to its refinery in Crockett, California. Roughly one million tons a year of sugar are harvested in Hawaii. A small portion is refined there; the bulk goes to Crockett. The refined sugar—the white stuff—is sold by C and H to groceries for home consumption and to the soft drink and cereal companies that are its industrial customers.

[3] To conduct its business, C and H has an imperative need for assured carriage for the raw sugar from the islands. Sugar is a seasonal crop, with 70 percent of the harvest occurring between April and October, while almost nothing is harvestable during December and January. Consequently, transportation must not only be available, but seasonably available. Storage capacity in Hawaii accommodates not more than a quarter of the crop. Left stored on the ground or left unharvested, sugar suffers the loss of sucrose and goes to waste. Shipping ready and able to carry the raw sugar is a priority for C and H.

[4] In 1979 C and H was notified that Matson Navigation Company, which had been supplying the bulk of the necessary shipping, was withdrawing its services as of January 1981. While C and H had some ships at its disposal, it found a pressing need for a large new vessel, to be in service at the

height of the sugar season in 1981. It decided to commission the building of a kind of hybrid—a tug of catamaran design with two hulls and, joined to the tug, a barge with a wedge which would lock between the two pontoons of the tug, producing an "integrated tug barge." In Hawaiian, the barge and the entire vessel were each described as a Mocababoo or push boat.

[5] C and H relied on the architectural advice of the New York firm, J.J. Henry. It solicited bids from shipyards, indicating as an essential term a "preferred delivery date" of June 1981. It decided to accept Sun's offer to build the barge and Halter's offer to build the tug.

[6] In the fall of 1979 C and H entered into negotiations with Sun on the precise terms of the contract. Each company was represented by a vice-president with managerial responsibility in the area of negotiation; each company had a team of negotiators; each company had the advice of counsel in drafting the agreement that was signed on November 14, 1979. This agreement was entitled "Contract for the Construction of One Oceangoing Barge for California and Hawaiian Sugar Company By Sun Ship, Inc." The "Whereas" clause of the contract identified C and H as the Purchaser, and Sun as the Contractor; it identified "one non-self-propelled oceangoing barge" as the Vessel that Purchaser was buying from Contractor. Article I provided that Contractor would deliver the Vessel on June 30, 1981. The contract price was $25,405,000.

[7] Under Article I of the agreement, Sun was entitled to an extension of the delivery date for the usual types of force majeure and for "unavailability of the Tug to Contractor for joining to the Vessel, where it is determined that Contractor has complied with all obligations under the Interface Agreement." (The Interface Agreement, executed the same day between C and H, Sun, and Halter provided that Sun would connect the barge with the tug.) Article 17 "Delivery" provided that "the Vessel shall be offered for delivery fully

and completely connected with the Tug." Article 8, "Liquidated Damages for Delay in Delivery" provided that if "Delivery of the Vessel" was not made on "the Delivery Date" of June 30, 1981, Sun would pay C and H "as per-day liquidated damages, and not as a penalty" a sum described as "a reasonable measure of the damages"—$17,000 per day.

[8] On the same date C and H entered into an agreement with Halter to purchase "one oceangoing catamaran tug boat" for $20,350,000. The tug (the "Vessel" of that contract) was to be delivered on April 30, 1981 at Sun's shipyard. Liquidated damages of $10,000 per day were provided for Halter's failure to deliver.

[9] Halter did not complete the tug until July 15, 1982. Sun did not complete the barge until March 16, 1982. Tug and barge were finally connected under C and H's direction in mid-July 1982 and christened the Moku Pahu. C and H settled its claim against Halter. Although Sun paid C and H $17,000 per day from June 30, 1981 until January 10, 1982, it ultimately denied liability for any damages, and this lawsuit resulted.

ANALYSIS

[10]Sun contends that its obligation was to deliver the barge connected to the tug on the delivery date of June 30, 1981 and that only the failure to deliver the integrated hybrid would have triggered the liquidated damage clause. It is true that Article 17 creates some ambiguity by specifying that the Vessel is to be "offered for delivery completely connected with the Tug." The case of the barge being ready while the tug was not, is not explicitly considered. Nonetheless, the meaning of "Vessel" is completely unambiguous. From the "Whereas" clause to the articles of the agreement dealing with insurance, liens, and title, "the Vessel" is the barge. It would require the court to rewrite the contract to find that "the Vessel" in Article 8 on liquidated damages does not

mean the barge. The article takes effect on failure to deliver "the Vessel"—that is, the barge.

[11]Sun contends, however, that on such a reading of the contract, the $17,000 per day is a penalty, not to be enforced by the court. The barge, Sun points out, was useless to C and H without the tug. Unconnected, the barge was worse than useless—it was an expensive liability. C and H did not want the barge by itself. To get $17,000 per day as "damages" for failure to provide an unwanted and unusable craft is, Sun says, to exact a penalty. C and H seeks to be "paid according to the tenour of the bond"; it "craves the law." And if C and H sticks to the letter of the bond, it must like Shylock end by losing; a court of justice will not be so vindictive. Breach of contract entitles the wronged party only to fair compensation.

[12]Seductive as Sun's argument is, it does not carry the day. Represented by sophisticated representatives, C and H and Sun reached the agreement that $17,000 a day was the reasonable measure of the loss C and H would suffer if the barge was not ready. Of course they assumed that the tug would be ready. But in reasonable anticipation of the damages that would occur if the tug was ready and the barge was not, Article 8 was adopted. As the parties foresaw the situation, C and H would have a tug waiting connection but no barge and so no shipping. The anticipated damages were what might be expected if C and H could not transport the Hawaiian sugar crop at the height of the season. Those damages were clearly before both parties. As Joe Kleschick, Sun's chief negotiator, testified, he had "a vision" of a "mountain of sugar piling up in Hawaii"—a vision that C and H conjured up in negotiating the damage clause. Given the anticipated impact on C and H's raw sugar and on C and H's ability to meet the demands of its grocery and industrial customers if the sugar could not be transported, liquidated damages of $17,000 a day were completely reasonable.

[13]The situation as it developed was different from the anticipation. The barge was not ready but neither was the tug.

C and H was in fact able to find other shipping. The crop did not rot. The customers were not left sugarless. Sun argues that, measured by the actual damages suffered, the liquidated damages were penal.

[14]We look to Pennsylvania law for guidance. Although no Pennsylvania case is squarely on point, it is probable that Pennsylvania would interpret the contract as a sale of goods governed by the Uniform Commercial Code. *Belmont Industries, Inc. v. Bechtel Corp.,* 425 F. Supp. 524, 527 (E.D.Pa.1976). The governing statute provides that liquidated damages are considered reasonable "in the light of anticipated or actual harm." 12A Pa. Cons. Stat. Ann. 2-718(1) (Purdon 1970) (Pennsylvania's adoption of the Uniform Commercial Code).

[15]The choice of the disjunctive appears to be deliberate. The language chosen is in harmony with the Restatement (Second) of Contracts § 356 (1979), which permits liquidated damages in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. Section 356, Comment b declares explicitly: "Furthermore, the amount fixed is reasonable to the extent that it approximates the loss anticipated at the time of the making of the contract, even though it may not approximate the actual loss."

[16]Despite the statutory disjunctive and the Restatement's apparent blessing of it, the question is not settled by these authorities which must be read in the light of common law principles already established and accepted in Pennsylvania. *Carpel v. Saget Studios, Inc.,* 326 F. Supp. 1331, 1333 (E.D. Pa.1971); 13 Pa. C.S.A. § 1103. Prior to the adoption of the Uniform Commercial Code, Pennsylvania enforced liquidated damage clauses that its courts labeled as nonpenal, but equitable considerations relating to the actual harm incurred were taken into account along with the difficulty of proving damages if a liquidated damage clause was rejected, e.g. *Emery v. Boyle,* 200 Pa. 249, 49 A. 779 (1901). We do not believe that the *U.C.C.* overrode this line of reasoning. Indeed, in a lower

court case, decided after the *U.C.C.*'s enactment, it was stated that if liquidated damages appear unreasonable in light of the harm suffered, "the contractual provision will be voided as a penalty." *Unit Vending Corp. v. Tobin Enterprises,* 194 Pa. Super. 470, 473, 168 A.2d 750, 751 (1961). That case, however, is not on all fours with our case: *Unit Vending* involved an adhesion contract between parties of unequal bargaining power; the unfair contract was characterized by the court as "a clever attempt to secure both the penny and the cake" by the party with superior strength. *Id.* at 476, 168 A.2d at 753. Mechanically to read it as Pennsylvania law governing this case would be a mistake. The case, however, does show that Pennsylvania courts, like courts elsewhere, attempt to interpret the governing statute humanely and equitably.

[17]The Restatement § 356 Comment b, after accepting anticipated damages as a measure, goes on to say that if the difficulty of proof of loss is slight, then actual damage may be the measure of reasonableness: "If, to take an extreme case, it is clear that no loss at all has occurred, a provision fixing a substantial sum as damages is unenforceable. See Illustration 4." Illustration 4 is a case of a contractor, A, agreeing to build B's race track by a specific date and to pay B $1,000 a day for every day's delay. A delays a month, but B does not get permission to operate the track for that month, so B suffers no loss. In that event, the Restatement characterizes the $1,000 per day as an unenforceable penalty. Sun contends that it is in the position of A: no actual loss was suffered by C and H because C and H had no tug to mate with the barge.

[18]This argument restates in a new form Sun's basic contention that the liquidated damage clause was meant to operate only if the integrated tug barge was not delivered. The argument has been rejected by us as a misinterpretation of the contract. But in its new guise it gains appeal. If Illustration 4 is the present case, Sun is home scot-free. The Restatement, however, deals with a case where the defaulting contractor was alone in his default. We deal with a case of

concurrent defaults. If we were to be so literal-minded as to follow the Restatement here, we would have to conclude that because both parties were in default, C and H suffered no damage until one party performed. Not until the barge was ready in March 1982 could C and H hold Halter for damages, and then only for the period after that date. The continued default of both parties would operate to take each of them off the hook. That cannot be the law.

[19]Sun objects that Halter had a more absolute obligation to deliver than Sun did. Halter did not have to deliver the integrated tug, only the tug itself; it was not excused by Sun's default. Hence the spectacle of two defaulting contractors causing no damages would not be presented here. But Sun's objection does not meet the point that Halter's unexcused delivery would, on Sun's theory, have generated no damages. The tug by itself would have been no use to C and H.

[20]We conclude, therefore, that in this case of concurrent causation each defaulting contractor is liable for the breach and for the substantial damages which the joint breach occasions. Sun is a substantial cause of the damages flowing from the lack of the integrated tug; Sun cannot be absolved by the absence of the tug.

[21]Sun has a final argument. Even on the assumption that it is liable as a substantial cause of the breach of contract, Sun contends that the actual damages suffered by C and H for lack of the integrated tug boat were slight. Actual damages were found by the district court to consist of "interest on progress payments, unfavorable terms of conversion to long-term financing, and additional labor expense." No dollar amount was determined by the district court in finding that these damages "bore a reasonable relationship to the amount liquidated in the Barge Contract."

[22]The dollar value of the damages found by the district judge is, to judge from C and H's own computation, as follows:

Additional Construction Interest	$1,486,000
Added Payments to J.J. Henry	161,000
Added Vessel Operating Expenses	73,000
C and H Employee Costs	109,000
TOTAL	$1,829,000

But "actual damages" have no meaning if the actual savings of C and H due to the nondelivery of the integrated tug barge are not subtracted. It was clearly erroneous for the district judge to exclude these savings from his finding. These savings, again according to C and H's own computation, were:

Transportation savings	$525,000
Lay-up costs	$936,000
TOTAL	$1,461,000

The net actual damages suffered by C and H were $368,000. As a matter of law, Sun contends that the liquidated damages are unreasonably disproportionate to the net actual damages.

[23]C and H urges on us the precedent of *Bellefonte Borough Authority v. Gateway Equipment & Supply Co.,* 442 Pa. 492, 277 A.2d 347 (1971), forfeiting a bid bond of $45,000 on the failure of a contractor to perform a municipal contract, even though the loss to the municipality was $1,000; the disproportion was 45 to 1. But that decision is not decisive here. It did not purport to apply the Uniform Commercial Code. Rules appropriate for bids to the government are sufficiently different from those applicable between private parties to prevent instant adoption of this precedent. A fuller look at relevant contract law is appropriate.

[24]Litigation has blurred the line between a proper and a penal clause, and the distinction is "not an easy one to draw in practice." *Lake River Corp. v. Carborundum Co.,* 769 F.2d

1284, 1290 (7th Cir.1985) (per Posner, J.). But the desire of courts to avoid the enforcement of penalties should not obscure common law principles followed in Pennsylvania. Contracts are contracts because they contain enforceable promises, and absent some overriding public policy, those promises are to be enforced. "Where each of the parties is content to take the risk of its turning out in a particular way" why should one "be released from the contract, if there were no misrepresentation or other want of fair dealing?" *Ashcom v. Smith,* 2 Pen. & W. 211, 218-219 (Pa. 1830) (per Gibson, C.J.). Promising to pay damages of a fixed amount, the parties normally have a much better sense of what damages can occur. Courts must be reluctant to override their judgment. Where damages are real but difficult to prove, injustice will be done the injured party if the court substitutes the requirements of judicial proof for the parties' own informed agreement as to what is a reasonable measure of damages. Pennsylvania acknowledges that a seller is bound to pay consequential damages if the seller had reason to know of the buyer's special circumstances. *Keystone Diesel Engine Co. v. Irwin,* 411 Pa. 222, 191 A.2d 376 (1963). The liquidated damage clause here functions in lieu of a court's determination of the consequential damages suffered by C and H.

[25]These principles inform a leading common law case in the field, *Clydebank Engineering & Shipbuilding Co. v. Yzquierdo y Castaneda,* 1905 A.C. 6. The defendant shipyard had agreed to pay 500 pounds per week per vessel for delay in the delivery of four torpedo boat destroyers to the Spanish Navy in 1897. The shipyard pointed out that had the destroyers been delivered on schedule they would have been sunk with the rest of the Spanish Navy by the Americans in 1898. The House of Lords found the defense unpersuasive. To prove damages the whole administration of the Spanish Navy would have had to have been investigated. The House of Lords refused to undertake such a difficult investigation when the parties had made an honest effort in advance to set in

monetary terms what the lack of the destroyers would mean to Spain.

[26]C and H is not the Spanish Navy, but the exact damages caused its manifold operations by lack of the integrated tug boat are equally difficult of ascertainment. C and H claimed that it suffered $3,732,000 in lost charter revenues. Testimony supported the claim, but the district court made no finding as to whether the claim was proved or unproved. The district court did find that the loss of charter revenues had not been anticipated by the parties. But that finding has no bearing on whether the loss occurred. Within the general risk of heavy losses forecast by both parties when they agreed to $17,000 per day damages, a particular type of loss was pointed to by C and H as having happened.

[27]Proof of this loss is difficult—as difficult, perhaps, as proof of loss would have been if the sugar crop had been delivered late because shipping was missing. Whatever the loss, the parties had promised each other that $17,000 per day was a reasonable measure. The court must decline to substitute the requirements of judicial proof for the parties' own conclusion. The Moku Pahu, available on June 30, 1981, was a great prize, capable of multiple employments and enlarging the uses of the entire C and H fleet. When sophisticated parties with bargaining parity have agreed what lack of this prize would mean, and it is now difficult to measure what the lack did mean, the court will uphold the parties' bargain. C and H is entitled to keep the liquidated damages of $3,298,000 it has already received and to receive additional liquidated damages of $1,105,000 with interest thereon, less setoffs determined by the district court.

[28]On the comparatively minor issue as to whether C and H is entitled to arbitration of its claim for a contract price reduction, Article 32 of the contract provides for arbitration of all disputes arising out of the contract with exceptions not applicable here. But no dispute remains for arbitration. The district court found that Sun was excused from performing its

mating obligations because the tug was not made available on March 11, 1982 when the barge was ready. C and H is not entitled to reimbursement from Sun for the costs it incurred in having the mating performed later by others. C and H was entitled to reimbursement for what it had paid Sun itself for the mating. But on the point system agreed to by the parties, this work represented 100 points out of possible 10,000 or 1 percent of the contract price. According to testimony offered on behalf of C and H, Sun credited C and H with a sum representing these 100 points. C and H's claim has been met. Arbitration is unnecessary.

[29]Sun has counterclaimed against C and H and Halter for misrepresentation, charging that the two companies had concealed from Sun the true progress on the tug. The alleged damages consist in the expenses Sun incurred trying to meet its own contractual obligations to build the barge. This counterclaim lacks plausibility on its face. No damage is inflicted on a party which is induced to perform its own contract. The cases Sun invokes to support its position involve "active interference" by one party with another party's performance. They have no applicability here.

[30]Uncontradicted testimony indicates, moreover, that Sun was aware of the delay. Employees of Sun were in touch with Halter. It would have been surprising if they had not been. Sun attempts to get around its actual knowledge by contending that it was not officially informed of the tug's progress. But the kind of knowledge that precludes the possibility of fraud does not have to be officially conveyed. Sun's counterclaim is meritless.

AFFIRMED.

5.2.1 Economic Justifications for Liquidated Damages

Recall from Restatement § 356, comment a, the assertion that:

> The parties to a contract are not free to provide a penalty for its breach. The central objective behind the system of contract

> remedies is compensatory, not punitive. Punishment of a promisor for having broken his promise has no justification on either economic or other grounds and a term providing such a penalty is unenforceable on grounds of public policy.

In their influential article on the subject, however, Professors Goetz and Scott challenge courts' hostility to liquidated damages clauses and explain several important economic justifications for enforcing contractually stipulated damages. The following excerpt summarizes their argument:

> [C]ontracting parties have incentives to negotiate liquidated damages clauses whenever the costs of negotiating are less than the expected costs resulting from reliance on the standard damage rule for breach. There are two primary factors which might induce the decision to negotiate:
>
> (1) The expected damages are readily calculable, but the parties determine that advance stipulation will save litigation or settlement costs;
>
> (2) The expected damages are uncertain or difficult to establish and the parties wish to allocate anticipated risks.
>
> Of course, these factors may be present singly or in combination.
>
> Pre-breach agreements will not be legally enforceable, however, unless two requirements coincide. First, the agreement must be a reasonable forecast of just compensation for the anticipated harm that would be caused by the breach. Second, the possible damages which might result from the breach must be uncertain and difficult to estimate. However, liquidated damages provisions have seldom been voided solely because the damages were easy to estimate.

Instead, courts have considered the degree of uncertainty an influential factor in determining the reasonableness of the estimate. If the conditions inducing damage agreements are viewed on a continuum, the application of the penalty rule becomes clearer: as the uncertainty facing the contracting parties increases, so does their latitude in stipulating post-breach damages.[xxxix]

The threat of subsequent review clearly increases the costs of negotiating a damages clause relative to relying on the standard damages rule. Are these costs accompanied by counterbalancing advantages? The traditional justification for post-breach inquiry is prevention of "unjust" punishment to the breacher, i.e. compensation exceeding the harm actually caused. This justification has been expressed in two distinct forms. One basis for invalidation is the presumption of unfairness: liquidated damage provisions are unreasonable—a penalty—whenever the stipulated sum is so disproportionate to provable damages as to require the inference that the agreement must have been effected by fraud, oppression, or mistake. The other major basis for invalidating agreed remedies is that, since the courts set damages based upon the principle of just compensation, parties should not be allowed to recover more than just compensation from the courts through a privately concocted alternative arrangement, even one fairly negotiated.

The common theme of these decisions is that a disproportion between the stipulated and the anticipated damage justifies an inference of overcompensation. In turn, overcompensation implies either bargaining unfairness or an objectionable *in terrorem*

> agreement to secure performance. This line of reasoning suggests two benefits which may be expected from the current rule invalidating penalties. First, the cost of identifying unfairness may be reduced by a standard rule-of-thumb based on disproportion. Second, an enforceable *in terrorem* clause might discourage promisors from breaching and reallocating resources where changed circumstances would ordinarily create efficiency gains from this behavior. Inducing performance under these conditions is a misallocation which prevents the net social gain that would result from nonperformance.
>
> [T]his analysis incorrectly assumes that, rather than negotiating out of the penalty, the promisor who is subject to an *in terrorem* clause will inevitably undertake an inefficient performance. In addition, there is no basis for the apparent assumption that the premium placed by the promisee on performance is valueless. Indeed, the market paradigm on which the compensation standard is based requires a contrary presumption; a promisee has a recognizable utility in certain *in terrorem* provisions and this utility is frequently reflected in willingness to pay a price for such clauses.

Charles J. Goetz & Robert E. Scott, Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach, *77 COLUM. L. REV. 554, 559-62 (1977).*

5.2.2 Discussion of C & H Sugar Co. v. Sun Ship and Lake River

What factors lead Judge Noonan to enforce the liquidated damages clause against Sun Ship?

Can you develop an argument that would raise doubt about whether the contractually specified damages were a reasonable estimate of the losses that C & H Sugar would be likely to suffer from breach? In this connection, consider what damages the company recovers when either Halter or Sun Ship breaches as compared to the damages recoverable when both suppliers breach.

Notice that Goetz and Scott claim in a footnote that "many cases have held that actual loss is irrelevant except as it permits inferences concerning the reasonableness of the agreements viewed ex ante." Is *C & H Sugar* one of those cases? How does the court use the evidence of actual losses in analyzing the parties' liquidated damages clauses?

How about *Lake River*? Does Judge Posner approach the question from an ex ante or ex post perspective?

Can you identify the policy basis for courts' reluctance to enforce liquidated damages clauses?

The End

Endnotes

[i] Corbin suggests that, even in situations where the court concludes that it would not have been natural for the parties to make the alleged collateral oral agreement, parol evidence of such an agreement should nevertheless be permitted if the court is convinced that the unnatural actually happened in the case being adjudicated. (3 Corbin, Contracts, § 485, pp. 478, 480; cf. Murray, *The Parol Evidence Rule: A Clarification* (1966) 4 *Duquesne L. Rev.* 337, 341-342.) This suggestion may be based on a belief that judges are not likely to be misled by their sympathies. If the court believes that the parties intended a collateral agreement to be effective, there is no reason to keep the evidence from the jury.

[ii] See *Goble v. Dotson* (1962) 203 Cal.App.2d 272, 21 Cal. Rptr. 769, where the deed given by a real estate developer to the plaintiffs contained a condition that grantees would not build a pier or boathouse. Despite this reference in the deed to the subject of berthing for boats, the court allowed plaintiffs to prove by parol evidence that the condition was agreed to in return for the developer's oral promise that plaintiffs were to have the use of two boat spaces nearby.

[iii] Counsel for plaintiffs direct our attention to numerous cases that they contend establish that parol evidence may never be used to show a collateral agreement contrary to a term that the law presumes in the absence of an agreement. In each of these cases, however, the decision turned upon the court's belief that the writing was a complete integration and was no more than an application of the rule that parol evidence cannot be used to vary the terms of a completely integrated agreement. (Cf. discussion in *Mangini v. Wolfschmidt, Ltd.*, supra, 165 Cal.App.2d 192, 203, 331 P.2d 728.) In *Gardiner v. McDonogh*, supra, 147 Cal. 313, 319, 81 P. 964, defendants sought to prove a collateral agreement that beams sold them were to conform to a sample earlier given. The court purportedly looked only to the face of the writing to decide whether parol evidence was admissible, and such evidence would be excluded if the writing was 'clear and complete.' Defendants argued that the written order was not complete because it did not fix a time and place of delivery, but the court answered that the failure to state those terms did not result in incompleteness because the law would supply them by implication. This decision was based on the belief that the question of admissibility had to be decided from that face of the instrument alone. Virtually every writing leaves some terms to be implied and almost none would qualify as integrations without implying some terms. The decision was therefore a product of an outmoded approach to the parol evidence rule, not of any compulsion to give conclusive effect to presumptions of implied terms.

[iv] In that year the Legislature set forth the rule in sections 1625 of the Civil Code and 1856 of the Code of Civil Procedure.

[v]The option was in the form of a reservation in a deed; however, in legal effect it is the same as if it had been contained in a separate document.

[vi] Citing three California cases (p. 547); *Hulse v. Juillard Fancy Foods Co.* (1964) 61 Cal.2d 571, 573, 39 Cal.Rptr. 529, 394 P.2d 65; *Schwartz v. Shapiro* (1964) 229 Cal.App.2d 238, 250, 40 Cal.Rptr. 189; *Mangini v. Wolfschmidt, Ltd.* (1958) 165 Cal.App.2d 192, 200-201, 331 P.2d 728.

[vii] The opinion continues: 'The terms and purpose of a contract may show, however, that it was intended to be nonassignable.' With this qualification of the general rule I am in accord, but here it is inapplicable as language indicating any intention whatever to restrict assignability is completely nonexistent.

[viii] Section 1044: 'Property of any kind may be transferred, except as otherwise provided by this Article.' The *only* property the article provides cannot be transferred is 'A mere possibility, not coupled with an interest.' (s 1045.)

Section 1458: 'A right arising out of an obligation is the property of the person to whom it is due, and may be transferred as such.'

[ix] Thus in *American Industrial Sales Corp. v. Airscope, Inc.* (1955) 44 Cal.2d 393, 397, 282 P.2d 504, 49 A.L.R.2d 1344, the contract was silent as to the place of payment for property purchased; in *Crawford v. France* (1933) 219 Cal. 439, 443, 27 P.2d 645, a contract for an architect's fee based upon the cost of a building was silent as to such cost; in *Buckner v. A. Leon & Co.* (1928) 204 Cal. 225, 227, 267 P. 693, a contract for sale and purchase of grapes was silent as to which party was to furnish the lug boxes required for delivery; in *Sivers v. Sivers* (1893) 97 Cal. 518, 521, 32 P. 571, a written agreement to repay money loaned was silent as to the time for payment; and *Simmons v. California Institute of Technology* (1949) 34 Cal.2d 264, 274(9), 209 P.2d 581, was a case of fraud in the inducement and not one of parol evidence to show a promise or agreement inconsistent with the written contract.

[x] It is the Legislature of this state which did the formulating of the rule governing parol evidence nearly a century ago when in 1872, as previously noted, sections 1625 of the Civil Code and 1856 of the Code of Civil Procedure were adopted. And as already shown herein, the rule has since been consistently applied by the courts of this state. The parol evidence rule as thus laid down by the Legislature and applied by the courts is the policy of this state.

[xi] Although the majority declare that this first 'policy' may be served by excluding parol evidence of agreements that directly contradict the writing, such contradiction is precisely the effect of the agreement sought to be shown by parol in this case.

[xii] '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.' (Comment 3, § 2-202; italics added.)

[xiii] Viz., proof of a collateral agreement should be permitted 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.' Restatement of Contracts, § 240, subd. (1)(b); italics added.)

[xiv] Or perhaps application of the new rule will turn upon the opinion of the court (trial or appellate) that it is "natural" for one family group to agree that in case of unfriendly approach by a creditor of any of them, then the debtor's property will be transferable or assignable only to other members of the family, whereas such a scheme might be considered less than "natural" for other families to pursue.

[xv] Thus in *American Industrial Sales Corp. v. Airscope, Inc.*, supra (1955) 44 Cal.2d 393, 397, 282 P.2d 504, the missing element was the place of payment of a note; in *Richter v. Union Land etc. Co*. (1900) 129 Cal. 367, 375, 62 P. 39, the missing element was the time of delivery; in *Wolters v. King* (1897) 119 Cal. 172, 175-176, 51 P. 35, it was the time of payment; and in *Mangini v. Wolfschmidt, Ltd.*, supra (1958) 165 Cal.App.2d 192, 200, 331 P.2d 728, and *Zinn v. Ex-Cell-O Corp*. (1957) 148 Cal.App.2d 56, 73-74, 306 P.2d 1017, it was the duration of an agency contract.

[xvi] In *Farmland Irrigation Co. v. Dopplmaier*, supra (1957) 48 Cal.2d 208, 222, 308 P.2d 732, 740, the court in holding that a patent license agreement was assignable pursuant to the policy "clearly manifested" by "the statutes in this state … in favor of the free transferability of all types of property, including rights under contracts," stated "The terms and purpose of a contract may show, however, that it was intended to be nonassignable. Thus the duties imposed upon one party may be of such a personal nature that their performance by someone else would in effect deprive the other party of that for which he bargained. The duties in such a situation cannot be delegated." (Citing *La Rue v. Groezinger* (1890) 84 Cal. 281, 283-285, 286, 24 P. 42, which held that a contract to sell grapes from a certain vineyard Was assignable to the purchaser of the vineyard, as nothing in the contract language excluded the "idea of performance by another," and (p. 287, 24 P. p. 44) there was "nothing in the nature or circumstances … which shows that the skill or other personal quality of the party was a distinctive characteristic of the thing stipulated for, or a material inducement to the contract.")

[xvii] As noted at the outset of this dissent, it was by means of the bankrupt's own testimony that defendants (the bankrupt's sister and her husband) sought to show that the option was personal to the bankrupt and thus not transferable to the trustee in bankruptcy.

[xviii] While article 2 of the Uniform Commercial Code which contains this section does not deal with the sale of securities, this section applies to article 8, dealing with securities. (Cf. *Agar v. Orda*, 264 N. Y. 248; Official Comment, McKinney's Cons. Laws of N. Y., Book 62 12, Part 1, Uniform Commercial Code, pp. 96-97; Note, 65 Col. L. Rev. 880, 890-891.) All parties and Special Term so regarded it.

[xix] Plaintiff does not challenge the trial court's denial of damages for delay in promotion or for anticipated royalties.

[xx] [Posner here cites] Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897) [which reads:

> Nowhere is the confusion between legal and moral ideas more manifest than in the law of contract. Among other things, here again the so called primary rights and duties are invested with a mystic significance beyond what can be assigned and explained. The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it – and nothing else. If you commit a tort, you are liable to pay a compensatory sum. If you commit a contract, you are liable to pay a compensatory sum unless the promised event comes to pass, and that is all the difference. But such a mode of looking at the matter stinks in the nostrils of those who think it advantageous to get as much ethics into law as they can.]

[xxi] PepsiCo argues that Klein has no right to sue on the PepsiCo/UJS contract because (1) the contract violates the statute of frauds, (2) Klein was not an intended beneficiary of the contract, and (3) the Klein/UJS contract, from which Klein derives his right to sue PepsiCo, was rescinded. The district court's discussion thoroughly and ably treats these claims and rejects them. Based on the district court's reasoning, this court affirms the disposition of those issues.

[xxii] According to Kells' testimony, both Mr. and Mrs. Sedmak visited Charlie's on January 9, 1978. Mrs. Sedmak testified only she visited Charlie's on that date.

[xxiii] § 400.2-201(3)(c) provides:

> (3) A contract which does not satisfy the requirements (of a writing) but which is valid in other respects is enforceable
>
> > (c) with respect to goods for which payment has been made and accepted or which have been received and accepted.

Interpreting this section, U.C.C. Comment 2 states:

'Partial performance' as a substitute for the required memorandum can validate the contract only for the goods which have been accepted or for which payment has been made and accepted. .... If the Court can make a just apportionment, ..., the agreed price of any goods actually delivered can be recovered without a writing or, if the price has been paid, the seller can be forced to deliver an apportionable part of the goods.

[xxiv] 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."

[xxv] 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.

[xxvi] In this opinion "affidavits" includes "declarations under penalty of perjury." (See Code Civ. Proc., § 2015.5.)

[xxvii] Although it would appear that plaintiff was not discharged by defendant in the customary sense of the term, as she was not permitted by defendant to enter upon performance of the "Bloomer Girl" contract, nevertheless the motion for summary judgment was submitted for decision upon a stipulation by the parties that "plaintiff Parker was discharged."

[xxviii] Instead, in each case the reasonableness referred to was that of the efforts of the employee to obtain other employment that was not different or inferior; his right to reject the latter was declared as an unqualified rule of law. Thus, *Gonzales v. Internat. Assn. of Machinists*, supra., 213 Cal.App.2d 817, 823-824, holds that the trial court correctly instructed the jury that plaintiff union member, a machinist, was required to make "such efforts as the average [member of his union] desiring employment would make at that particular time and place" (italics added); but, further, that the court properly rejected defendant's offer of proof of the availability of other kinds of employment at the same or higher pay than plaintiff usually received and all outside the jurisdiction of his union, as plaintiff could not be required to accept different employment or a nonunion job.

[xxix] The issue is generally discussed in terms of a duty on the part of the employee to minimize loss. The practice is long-established and there is little reason to change despite Judge Cardozo's observation of its subtle inaccuracy. "The servant is free to accept employment or reject it according to his uncensored pleasure. What is meant by the supposed duty is merely this, that if he unreasonably reject, he will not be heard to say that the loss of wages from then on shall be deemed the jural consequence of the earlier discharge. He has broken the chain of causation, and loss resulting to him thereafter is suffered through his own act." (*McClelland v. Climax Hosiery Mills* (1930) 252 N.Y. 347, 359 [169 N.E. 605, 609], concurring opinion.)

[xxx] This qualification of the rule seems to reflect the simple and humane attitude that it is too severe to demand of a person that he attempt to find and perform work for which he has no training or experience. Many of the older cases hold that one need not accept work in an inferior rank or position nor work which is more menial or arduous. This suggests that the rule may have had its origin in the bourgeois fear of resubmergence in lower economic classes.

[xxxi] See also 28 A.L.R. 736, 740-742; 15 Am.Jur. 431

[xxxii] The earliest California case which the majority cite is *de la Falaise v. Gaumont-British Picture Corp.*, supra., 39 Cal.App.2d at p. 469. *de la Falaise* states "The other employment' which the discharged employee is bound to seek is employment of a character substantially similar to that of which he has been deprived; he need not enter upon service of a different or inferior kind, ..." *de la Falaise* cites, in turn, two sources as authority for this proposition. The first is 18 R.C.L. (Ruling Case law) 529. That digest, however, states only that the "discharged employee ... need not enter upon service of a more menial kind." (Italics added.) It was in this form that the rule entered California law explicitly, *Gregg v. McDonald* (1925) 73 Cal. App. 748, 757 [239 P. 373], quoting the text verbatim. The second citation is to 28 A.L.R. 737. The author of the annotation states: "The principal question with which this annotation is concerned is the kind of employment which the employee is under a duty to seek or accept in order to reduce the damages caused by his wrongful discharge. Must one who is skilled in some special work he is employed to do, as an actor, musician, accountant, etc., seek or accept employment of an entirely different nature?" (Italics added.) (28 A.L.R. 736.) In answering that question in the negative, the annotation employs the language adopted by the majority: The employee is "not obliged to seek or accept other employment of a different or inferior kind, ..." (Id. at p. 737.) Rather than a restatement of a generally agreed upon rule, however, the phrase is an epitomization of the varied formulations found in the cases cited. (See 28 A.L.R. 740-742.)

[xxxiii] The values of the doctrine of mitigation of damages in this context are that it minimizes the unnecessary personal and social (e.g.. nonproductive use of labor, litigation) costs of contractual failure. If a wrongfully discharged employee can, through his own action and without suffering financial or psychological loss in the process, reduce the damages accruing from the breach of contract, the most sensible policy is to require him to do so. I fear the majority opinion will encourage precisely opposite conduct.

[xxxiv] Plaintiff's declaration states simply that she has not received any payment from defendant under the "Bloomer Girl" contract and that the only persons authorized to collect money for her are her attorney and her agent.

[xxxv] Evidence Code section 455 provides in relevant part: "With respect to any matter specified in Section 452 or in subdivision (f) of Section 451 that is of substantial consequence to the determination of the action: (a) If the trial court has been requested to take or has taken or proposes to take judicial notice of such matter, the court shall afford each party reasonable opportunity, before the jury is instructed or before the cause is submitted for decision by the court, to present to the court information relevant to (1) the propriety of taking judicial notice of the matter and (2) the tenor of the matter to be noticed."

[xxxvi]Fox filed two declarations in opposition to the motion; the first is that of Frank Ferguson, Fox's chief resident counsel. It alleges, in substance, that he has handled the negotiations surrounding the "Bloomer Girl" contract and its breach; that the offer to employ plaintiff in "Big Country" was made in good faith and that Fox would have produced the film if plaintiff had accepted; that by accepting the second offer plaintiff was not required to surrender any rights under the first (breached) contract nor would such acceptance have resulted in a modification of the first contract; that the compensation under the second contract was identical; that the terms and conditions of the employment were substantially the same and not inferior to the first; that the employment was in the same general line of work and comparable to that under the first contract; that plaintiff often makes pictures on location in various parts of the world; that article 2 of the original contract which provides that Fox is not required to use the artist's services is a standard provision in artists' contracts designed to negate any implied covenant that the film producer promises to play the artist in or produce the film; that it is not intended to be an advance waiver by the producer of the doctrine of mitigation of damages.

[xxxvii] jointly and severally against both defendants, viz., Harold Schectman, the contracting party, and the company which issued the performance bond, United States Fire Insurance Company. Inasmuch as the interests of both defendants here are identical, for the purpose of this appeal and for the sake of simplicity we treat the defendants as one: i.e., the contracting party, Harold Schectman. A third-party action commenced by the bonding company on an indemnity agreement between it and defendant Schectman and others is not part of this appeal. The appeal is also taken from an order denying defendant's motion to set aside the verdict and for a new trial.

[xxxviii] Paragraph 7 of the agreement states in pertinent part: "7. After the Closing Date, Purchaser shall demolish all of the Improvements on the North Tonawanda Property included in the sale to Purchaser, cap the water intake at the pumphouse end, and grade and level the property, all in accordance with the provisions of Exhibit 'C' and 'C1' attached hereto." Exhibit C (notes on demolition and grading) contains specifications for the grade levels for four separate areas shown on Map C1 and the following instruction: "Except as otherwise excepted all structures and equipment including foundations, piers, headwalls, etc. shall be removed to a depth approximately one foot below grade lines as set forth above. Area common to more than one area will be faired to provide reasonable transitions, it being intended to provide a reasonably attractive vacant plot for resale."

xxxix It appears that the drafters of the Uniform Commercial Code have tacitly adopted this approach. Section 2-718(1) of the U.C.C. allows parties to liquidate damages for breach as long as the amount stipulated is "reasonable." The reasonableness of a particular amount is determined, in part, by the "difficulties of proof of loss" from the breach. While it might be argued that the U.C.C. rule approximates the common law uncertainty requirement, as does the 1 New York Law Revision Commission, Report of the Law Revision Commission for 1955, State of New York, Study of the Uniform Commercial Code 581-82, it appears that a change has been made. The language of U.C.C. § 2-718 itself treats "uncertainty" as merely one factor, and not even a required one, of many to be considered in determining reasonableness.

In addition to uncertainty, courts have also been influenced by the relationship between the stipulated amount and the provable harm actually caused by the breach. Although a number of courts have refused to enforce agreements because of the absence of provable losses upon breach, many cases have held that actual loss is irrelevant except as it permits inferences concerning the reasonableness of the agreements viewed ex ante. *Frick Co. v. Rubel Corp*., 62 F.2d 765, 767-68 (2d Cir. 1933); *In re Lion Overall Co*., 55 F. Supp. 789 (S.D.N.Y. 1943,. aff'd sub nom, *United States V. Walkof*, 144 F.2d 75 (2d Cir. 1944); *Bryon Jackson Co. v. United States*, 35 F. Supp. 665 (S.D. Cal. 1940); *McCarthy v. Tally*, 46 Cal.2d 577. 297 P.2d 981 (1956). But see *Rowe v. Shehyn*, 192 F. Supp. 428 (D.D.C. 1961); *Marshall v. Patzman*, 81 Ariz. 367, 370-71, 306 P.2d 287, 290-91 (1957); *Gorco Constr. Co. v. Stein*, 256 Minn. 476. 481-84, 99 N.W.2d 69, 74-76 (1959). See generally *Macneil*, supra note 14, at 504-509: *Sweet, Liquidated Damages in California*, 60 Calif. L. Rev. 84, 131-33 (1972).