



The Story of Contract Law: Implementing the Bargain

VAL RICKS



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Notices

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Introduction: Implementing the Bargain

Many judges and scholars of contract law focus their attention on the parties' assent, on agreement. But the doctrine of contract law itself focuses on the enforcement of a promise, one promise at a time. The central organizing rule for enforcement—the idea that ties the doctrines of contract law together—is that the promise must be part of a fair exchange. In formation doctrine, courts ensure an exchange by requiring consideration (which itself requires assent) but police the fairness of the exchange through the doctrines of mistake, duress, misrepresentation, undue influence, and unconscionability.

Separating contract law into doctrines of formation, interpretation, conditions, subsequently occurring events, remedies, and third-party interests, as I do in this book, distracts to some extent from discussion of the primary goal of contract doctrine, which is to enforce fair exchange. In the cases studied in this volume, courts continue to discern and police the bargain of the parties. Of course, the meaning of “fair” will depend on the goals of the court; contract doctrine, like most legal doctrine, lies at the level of generality (not too general, not too specific) that allows the plurality of views necessary for a legal system comprising diverse and strong-willed individuals to function. Nevertheless, if you are discerning, you should expect and be able to find in these materials arguments for and against fairness based on autonomy, welfare, and other moral claims, just as you did for the doctrines of formation in Volume I.

In the end, I hope you will see, notwithstanding its occasional missteps, what a remarkable achievement contract law is and how it meshes with the culture, and encourages the success, of a mostly honest and very ambitious people whose cooperation together is vital to their flourishing.

—Val Ricks

I. What Is the Bargain?

Promises and contracts are made up of words. The words' meaning might be clear or unclear. The words might be written or oral. They might be gathered in one place or scattered among many documents. They might even be placed in a document by mistake. The words might be words of promise, but contracts often also contain conditions, representations, statements of factual background, and other terms. Sometimes courts by law "read into" or imply in contracts terms that the parties were not aware they needed but that are suggested by the parties' bargain.

In this first section of the casebook, we examine all the ways by which courts determine the content of the bargain. We will examine how a court determines what words in a contract mean (Subsection A), how the court decides which words are included in the contract (Subsection B), what other obligations are implied by the parties' bargain (Subsection C), what courts do with language of condition (Subsection D), and how courts decide who should perform first if the parties have not said (Subsection E).

A. The Meaning of the Words: Interpretation or Construction?

After a contract forms, any attempt to enforce it requires the parties and the court to know what the words of the contract mean. As you might expect, the meaning of contractual words is sometimes not obvious. What is a court to do when the parties have agreed to words the meaning of which is unclear?

1. The "Plain Meaning" Rule or Not—When to Take Evidence About Meaning

The following case, *Tips*, illustrates what the law calls the "plain meaning rule." This case involves a negotiable instrument, namely, a promissory note. "Negotiable" means the instrument can be signed on the back by the promisee and traded (often at near face value) to someone else, like a check when it is cashed or deposited at a bank. Negotiable instruments are in a standard form that is supposed to be easily tradable, almost like cash. You can perhaps see why we would not want the terms of a negotiable instrument to be endlessly debatable. But this case also involved non-negotiable contracts, namely, a mortgage and a guaranty. These are just ordinary contracts. They cannot be negotiated (though they can be assigned). Should the rule in this case apply to all contracts? Or should we call some witnesses?

CHARLES R. TIPS FAMILY TRUST, HAZEL W. TIPS FAMILY TRUST, AND
CHARLES T. WATKINS v. PB COMMERCIAL LLC
Tex. App. (2015), 459 S.W.3d 147

OPINION

MICHAEL MASSENGALE, Justice.

[¶1] The parties to this appeal entered into a residential loan agreement and guaranty for the principal amount of "ONE MILLION SEVEN THOUSAND AND NO/100 (\$1,700,000.00) DOLLARS." The loan documentation thus identified the amount of the loan in two different ways, with one number favoring the borrower—one million seven thousand—written out in words and a larger number favoring the bank—\$1,700,000—set out in numerals. The bank alleged a default on the loan, and litigation ensued. The parties filed competing motions for summary judgment, and the trial court rendered a final summary judgment in favor of the bank.

[¶2] The borrowers and their guarantor appeal, arguing that the written words control the meaning of the document and that the note has been satisfied in full. Applying the well-settled interpretive rule that "words prevail over numbers" in the event of such a discrepancy, we reverse in part, affirm in part, and remand the case to the trial court for further proceedings.

Background

[¶3] In 2007, the Charles R. Tips Family Trust and the Hazel W. Tips Family Trust executed a "Balloon Real Estate Note" in favor of Patriot Bank. The note was secured by real property in Harris County pursuant to a "Deed of Trust and Security Agreement." The same day, Charles Watkins, a trustee of both trusts, executed a "Guaranty Agreement" in favor of Patriot Bank, obligating himself to personally pay the loan if the trusts defaulted on their payment obligations. The note, the security agreement, and the guaranty agreement all described the principal amount of the loan as follows:

ONE MILLION SEVEN THOUSAND AND NO/100 (\$1,700,000.00) DOLLARS

This language appears five times in the three documents, in exactly the same form each time, and no other language in the documents describes the amount of the loan.

[¶4] Before the note matured, the trusts made payments totaling \$595,586. Neither the trusts nor Watkins made any further payments, and Patriot Bank initiated this action to collect the balance due on the note as well as unpaid interest. PB Commercial, LLC ("PBC") subsequently acquired the note and sold the property securing it at auction for \$874,125. PBC was then substituted as plaintiff.

[¶5] PBC filed a motion for traditional summary judgment, seeking recovery on both the note and the guaranty agreement. PBC argued that the original principal amount of the loan was \$1,700,000, and on that basis it calculated a deficiency under the note and guaranty agreement of \$815,214.50 after application of all payments and the proceeds from the foreclosure sale. PBC attached the note, security agreement, and guaranty agreement to its motion, but it made no mention of the conflict between the printed words and numerals. It also attached a payment history showing how Patriot Bank applied payments against the loan, treating the principal amount as \$1,700,000.

[¶6] The trusts and Watkins responded by amending their answer, filing a counterclaim, responding to PBC's motion for summary judgment, and filing a cross-motion for summary judgment. In these filings, the trusts and Watkins argued that the original principal amount of the loan under the note and guaranty agreement was \$1,007,000. They argued that both documents are negotiable instruments governed by Section 3.114 of the Texas Business and Commerce Code, which provides: "If an instrument contains contradictory terms, typewritten terms prevail over printed terms, handwritten terms prevail over both, and words prevail over numbers." TEX. BUS. & COM. CODE § 3.114. According to the trusts and Watkins, applying past payments and the foreclosure sale proceeds to the lower amount leads to the conclusion that the note was fully satisfied after the foreclosure sale and, in fact, PBC has collected a surplus of \$189,111 beyond the amount to which it was entitled.

[¶7] The amended answer included a counterclaim, which sought a declaration that:

- (a) the . . . Note . . . was for the original principal amount of \$1,007,000; and not \$1,700,000;
- (b) the Note has been fully paid and satisfied as a result of the payments made thereon prior to the Trusts' alleged default, and the amount collected by Plaintiff through the post-default foreclosure upon and sale of the real property pledged as security under the Note;
- (c) Watkins is relieved of any further obligation under the Guaranty; and
- (d) [PBC] is retaining and holding money obtained through the foreclosure sale that is in excess of the amount necessary to fully pay and satisfy the amounts due under the Note.

The counterclaim also sought unspecified statutory damages under the Business and Commerce Code and an award of attorney's fees. Notably, however, the cross-motion for summary judgment requested only that the trial court deny PBC's motion and award the trusts the alleged surplus resulting from the foreclosure sale. The cross-motion did not mention the claims for attorney's fees or statutory damages, nor did it provide any legal basis or evidentiary support for those claims.

[¶8] After a pair of hearings, the trial court granted PBC's motion and denied the cross-motion filed by the trusts and Watkins. The trial court's final judgment awarded PBC damages in the amount of \$815,214.50, prejudgment and postjudgment interest, court costs, and trial and appellate attorney's fees. The trusts and Watkins appeal.

Analysis

[¶9] This appeal presents one issue: whether the amount of the loan must be determined from the printed words in the note or from the entire context of the transaction, including evidence of the amount of money that Patriot Bank actually made available to the borrowers. Once we have determined the amount of the loan, the trusts and Watkins ask us to reverse the trial court's judgment as to PBC's claims and render judgment in their favor or remand for further proceedings.

[¶10] This court reviews an order granting or denying a motion for summary judgment *de novo*. *Tex. Mun. Power Agency v. Pub. Util. Comm'n of Tex.*, 253 S.W.3d 184, 192 (Tex. 2007). When both parties moved for summary judgment and the trial court granted one and denied the other, we "review the summary judgment evidence presented by each party, determine all questions presented, and render judgment as the trial court should have rendered." *Id.* We may affirm the judgment that the trial court rendered or reverse and render the judgment that the trial court should have rendered. See *FM Props. Operating Co. v. City of Austin*, 22 S.W.3d 868, 872 (Tex. 2000).

[¶11] The trusts and Watkins characterize the "Balloon Real Estate Note" as a promissory note* and as a negotiable instrument,† and PBC does not dispute this characterization. To recover on a promissory note on which the borrower has defaulted, PBC was required to prove that (1) the note existed, (2) the maker or makers of the note signed it, (3) it was the legal owner and holder of the note, and (4) a certain balance was due and owing on the note. See, e.g., *Wells Fargo Bank, N.A. v. Ballestas*, 355 S.W.3d 187, 191 (Tex. App.-Houston [1st Dist.] 2011, no pet.); *Clark v. Dedina*, 658 S.W.2d 293, 295 (Tex. App.-Houston [1st Dist.] 1983, writ *dism'd*).

[¶12] To recover on the guaranty agreement, PBC was required to prove "the existence and ownership of the guaranty contract, the terms of the underlying contract by the holder, the occurrence of the conditions upon which liability is based, and the failure or refusal to perform by the guarantor." *McShaffry v. Amegy Bank Nat'l Ass'n*, 332 S.W.3d 493, 496 (Tex. App.—Houston [1st Dist.] 2009, no pet.); see also *Wasserberg v. Flooring Servs. of Tex., LLC*, 376 S.W.3d 202, 205 (Tex. App.—Houston [14th Dist.] 2012, no pet.).

[¶13] To recover the amount remaining due under the note and guaranty agreement after the foreclosure sale, PBC was required to prove "(1) the amount due on the note at the time of foreclosure, (2) that proper notice of acceleration had been given, (3) that a valid foreclosure sale was made and (4) that [PBC] has given credit to the [debtors] for the amount received at the trustee's sale and any other legitimate credits." *Carruth Mortg. Corp. v. Ford*, 630 S.W.2d 897, 899 (Tex. App.—Houston [1st Dist.] 1982, no writ); see also

* A "promissory note" is: "An unconditional written promise, signed by the maker, to pay absolutely and in any event a certain sum of money either to, or to the order of, the bearer or a designated person." BLACK'S LAW DICTIONARY 1226 (10th ed. 2014).

† See TEX. BUS. & COM. CODE § 3.104(a)-(d).

Collins v. Bayview Loan Servicing, LLC, 416 S.W.3d 682, 686 (Tex. App.—Houston [14th Dist.] 2013, no pet.). When a party holding a security interest recovers more than the amount of the obligation, it must pay out any amounts due to certain third parties, then account for and pay to the debtor the remaining surplus. TEX. BUS. & COM. CODE § 9.615(d)(1); see also *id.* § 9.615(a), (c).

[¶14] If a written instrument is worded in such a way that it can be given a definite or certain legal meaning, then the contract may be construed as a matter of law. *Coker v. Coker*, 650 S.W.2d 391, 393 (Tex. 1983). "An unambiguous contract will be enforced as written, and parol evidence will not be received for the purpose of creating an ambiguity or to give the contract a meaning different from that which its language imports." *David J. Sacks, P.C. v. Haden*, 266 S.W.3d 447, 450 (Tex. 2008); see also *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. CBI Indus., Inc.*, 907 S.W.2d 517, 520 (Tex. 1995) (*per curiam*).

[¶15] Whether a contract is ambiguous is a question of law, which we review *de novo*. *Coker*, 650 S.W.2d at 394. When a contract contains an ambiguity, summary judgment is precluded because interpretation of the contract becomes a fact issue. *Id.* (citing *Harris v. Rowe*, 593 S.W.2d 303, 306 (Tex. 1979)).

[¶16] A simple lack of clarity or disagreement between parties does not render a term ambiguous. See *DeWitt Cnty. Elec. Coop., Inc. v. Parks*, 1 S.W.3d 96, 100 (Tex. 1999). Rather, "[a]n ambiguity arises only after the application of established rules of construction leaves an agreement susceptible to more than one meaning." *Id.* "[F]or an ambiguity to exist, both potential meanings must be reasonable." *Id.* "Whether a contract is ambiguous is a question of law for the court to decide by looking at the contract as a whole in light of the circumstances present when the contract was entered." *Coker*, 650 S.W.2d at 394. If the contract is ambiguous as a matter of law, only then is parol evidence of the parties' interpretation of the contract admissible. *Pitts & Collard, L.L.P. v. Schechter*, 369 S.W.3d 301, 313 (Tex. App.—Houston [1st Dist.] 2011, no pet.).

[¶17] Texas law anticipates internal contradictions in both negotiable and non-negotiable instruments and provides for the resolution of such contradictions. Under the Uniform Commercial Code, which governs negotiable instruments such as the Note, "[i]f an instrument contains contradictory terms, typewritten terms prevail over printed terms, handwritten terms prevail over both, and words prevail over numbers." TEX. BUS. & COM. CODE § 3.114; see also *McNeese v. State*, 596 S.W.2d 906, 907 (Tex. Crim. App. [Panel Op.] 1980); *Taylor v. State*, 672 S.W.2d 262, 264 (Tex. App.—Waco 1984, no writ). "It is well settled that unambiguous written words prevail over arithmetic numbers in promissory notes." *First State Bank v. Keilman*, 851 S.W.2d 914, 920 (Tex. App.—Austin 1993, writ denied); see also *Duvall v. Clark*, 158 S.W.2d 565, 567 (Tex. Civ. App.—Waco 1941, writ ref'd w.o.m.) ("It is elementary that the written words of an instrument control and prevail over figures."). This rule derives from the principle that "writing words more likely represents the parties' true intentions than writing numbers." 6B LARY LAWRENCE, ANDERSON ON THE UNIFORM COMMERCIAL CODE § 3-114:5R

(3d ed. rev'd 2003); see also 6 WILLIAM D. HAWKLAND & LARY LAWRENCE, HAWKLAND & LAWRENCE UCC SERIES § 3.114:1 (1999) ("Words are preferred because writing words more likely effects the parties' true intentions than writing numbers."); *France v. Ford Motor Credit Co.*, 913 S.W.2d 770, 772 (Ark. 1996) (noting application of identical statute when individual wrote both "8,000.00" and "Eight dollars and 00/100" on check to creditor, resulting in payment of eight dollars). The same interpretive rule applies to non-negotiable instruments. See *Guthrie v. Nat'l Homes Corp.*, 394 S.W.2d 494, 495 (Tex. 1965).

I. Interpretation of contractual language

A. Unambiguity of loan amount

[¶18] We first must examine whether the loan agreements are ambiguous. If so, then summary judgment was improper for that reason. *Coker*, 650 S.W.2d at 394; *Harris*, 593 S.W.2d at 306; *Simpson v. GEICO Gen. Ins. Co.*, 907 S.W.2d 942, 945 (Tex. App.—Houston [1st Dist.] 1995, no writ).

[¶19] The Note, Security Agreement, and Guaranty Agreement each describe the original amount of the loan obligation as "ONE MILLION SEVEN THOUSAND AND NO/100 (\$1,700,000.00) DOLLARS." The phrase "one million seven thousand and no/100 dollars" has a plain, unambiguous meaning, namely the sum of \$1,007,000.00. Thus, the words and the numerals in the loan agreements are in conflict, differing by \$693,000. This impact is magnified by the fact that the actual amount of the loan affects the application of payments, resulting in different sums of interest due in each scenario.

[¶20] In *Guthrie v. National Homes Corp.*, 394 S.W.2d 494 (Tex. 1965), the Supreme Court of Texas considered a similar case, in which the instrument in question stated that the obligor would pay "\$5,780.00," which was written out as "Five Thousand Eighty and 00/100 Dollars." *Guthrie*, 394 S.W.2d at 495. The Court held that the words "Five Thousand Eighty and 00/100 Dollars" were unambiguous and controlled the numerals. *Id.* at 495-96. A jury had returned a verdict that, because \$5,000 had been paid on the note, the obligor still owed \$780. *Id.* at 494. In light of the unambiguous written words of the instrument, however, there was no fact issue regarding the original amount of the loan for the jury to consider, and the Court reduced the award to \$80 to match the words of the instrument. *Id.* at 496. The Court recognized that the rule favoring words over numerals already applied to negotiable instruments such as promissory notes and held that the same rule applies to non-negotiable instruments. *Id.* at 495-96.

[¶21] Similarly, in *First State Bank v. Keilman*, 851 S.W.2d 914 (Tex. App.—Austin 1993, writ denied), the parties' agreement stated that interest would be paid at the "prime rate . . . plus Two percent (12.5%)," but "12.5%" was crossed out and the number "2%" written in. *First State Bank*, 851 S.W.2d at 920. The court of appeals explained that "[i]t is well settled that unambiguous written words prevail over arithmetic numbers in promissory

notes." *Id.* Thus, even though handwritten or typed text ordinarily prevails over printed terms in an instrument, the alteration had no effect, as the written words would still control over the interpretation of the arithmetic numbers "12.5%" and "2%." *Id.*; see also Duvall, 158 S.W.2d at 567 (handwritten change from "\$900.00" to "\$930.00" was immaterial because written words setting payment at six percent of \$15,000 controlled and were not altered).

[¶22] Under the UCC and Guthrie, the rule that the written words control over numerals applies to all of the documents at issue in this dispute, both negotiable and non-negotiable instruments. TEX. BUS. & COM. CODE § 3.114; Guthrie, 394 S.W.2d at 495-96. It does not matter that the discrepancy between the words and numbers here is a large one. Neither Section 3.114 nor Texas case law makes a distinction on the basis of the size of the obligation or the significance of the conflict in terms. Indeed, at least one court has applied the logic of Guthrie in holding that words controlled over numbers when a discrepancy was even larger relative to the transaction size than it is here. In *In re Regency Chevrolet, Inc.*, 122 B.R. 60 (Bankr. S.D. Tex. 1990) (mem. op.), the bankruptcy court for the Southern District of Texas held that the terms "Seventeen Thousand Five Hundred Dollars (\$10,000.00)" and "Seventeen Thousand Five Hundred Dollars (\$14,000.00)" in two different leases created two monthly obligations of \$17,500.00 each. 122 B.R. at 61-62 (citing Guthrie, 394 S.W.2d at 494).

[¶23] PBC argues that this case presents a unique circumstance in that the omission of a single word transforms "one million seven hundred thousand" into "one million seven thousand." If the former phrase were modified in any other way, according to PBC, we would be faced with either an ambiguous term or an unambiguous but absurd one. For example, PBC posits a scenario in which a scrivener's error rendered the phrase as "one seven hundred thousand," omitting the word "million." According to PBC, such an amount would be ambiguous, and the court would have to refer to the numerals and extrinsic evidence to resolve the ambiguity. But this hypothetical scenario has no bearing on this case because there is no ambiguity in the text here. Indeed, in the scenario described by PBC, one could not even say that the terms contradict each other within the meaning of Section 3.114, as the meaning of one of the potentially conflicting terms would be ambiguous.

[¶24] Alternatively, PBC suggests a scenario in which another scrivener's error replaced "million" with "billion," resulting in "one billion seven hundred thousand." This, PBC says, would result in the borrowers clamoring for relief and asking this court to consider evidence extrinsic to the contract. That may be, and the possibility of such an error demands careful review of proposed written agreements. But that is no basis upon which we may disregard well-settled and binding statutory and case law. We need not and do not express any opinion on what legal or equitable remedies the parties might have in such a hypothetical scenario. On the appellate record before us, the only issue is what the terms of the written agreements mean as a matter of law. Neither party sought an equitable reformation of the loan in the trial court, so no issue of equitable relief has been presented

in this appeal. The scenario proposed by PBC thus has no bearing on how we must apply the law to the record before us.

[¶25] Here, the words "one million seven thousand" control over the numerals "\$1,700,000" to set the amount of the promissory note and guaranty obligations.

B. Irrelevance of extrinsic evidence

[¶26] PBC also argues that the trial court properly considered evidence before it that the borrowers received \$1,700,000 from Patriot Bank. But a court may not consider extrinsic evidence about a contract's meaning unless the contract is ambiguous. PBC does not contend that the documents are ambiguous; any material ambiguity in the contracts would have made summary judgment for PBC improper for that reason alone. *Coker*, 650 S.W.2d at 394; *Harris*, 593 S.W.2d at 306; *Simpson*, 907 S.W.2d at 945.

[¶27] A document is ambiguous only if it is susceptible to more than one reasonable interpretation after application of all relevant rules of construction. *DeWitt Cnty. Elec. Coop.*, 1 S.W.3d at 100. Only one interpretation of the language in question is possible in light of controlling law.

[¶28] The agreements unambiguously set the amounts of the promissory note and guaranty obligations at \$1,007,000.00 each. Because the amount of principal set forth in the Note and Guaranty Agreement is not ambiguous, for purposes of interpreting the documents as a matter of law, neither the trial court nor this court may consider extrinsic evidence such as the amount of money that actually changed hands amongst the parties, and such evidence could not have supported the trial court's judgment. *Pitts & Collard*, 369 S.W.3d at 313. * * * *

[¶29] To recover on the Note, PBC was required to prove that a certain balance was due and owing on the Note. *Clark*, 658 S.W.2d at 295. It has failed to do so and did not even address the correct amount of the loan in its motion for summary judgment. Further, to recover on the alleged deficiency, PBC was required to prove "the amount due on the note at the time of foreclosure." *Carruth Mortg. Corp.*, 630 S.W.2d at 899. This it has also failed to do. Instead, PBC's position depends on extrinsic evidence that the amount due should be calculated based on an amount other than the amount fixed by the Note. Because the trial court could not have considered such evidence, we hold that PBC was not entitled to summary judgment on its claims for damages, interest, costs, or attorney's fees stemming from the trusts' default under the Note.

[¶30] To recover on the Guaranty Agreement, PBC was required to prove "the terms of the underlying contract by the holder." *McShaffry*, 332 S.W.3d at 496. Again, because PBC's claims depended on a misinterpretation of the unambiguous language of the Note, PBC has failed to demonstrate that it was entitled to summary judgment against Watkins under the Guaranty Agreement.

[¶31] Because PBC did not establish each of the elements of any of its causes of action, it was not entitled to summary judgment. We will therefore reverse the trial court's judgment insofar as it granted judgment in favor of PBC on its affirmative claims.

B. Motion for summary judgment filed by the trusts and Watkins

[¶32] Our inquiry does not stop here, however, as the trusts and Watkins argue that their motion for summary judgment was wrongly denied. When the parties file competing motions for summary judgment, on appeal we "review both sides' summary judgment evidence," "determine all questions presented," and "render the judgment that the trial court should have rendered." FM Props., 22 S.W.3d at 872. We must therefore determine whether the trusts and Watkins were entitled to summary judgment.

[¶33] In their motion, the trusts and Watkins argued that the amount of the Note was \$1,007,000, resulting in the Note having been completely satisfied by the time that the lawsuit was filed. They argue that they made payments of \$595,586, which, applied to the principal of \$1,007,000, should have resulted in application of \$273,600 to interest and \$321,986 to principal. The foreclosure sale yielded an additional \$874,125. Adding these numbers together yields total payments of \$1,196,111. Based on a loan amount of \$1,007,000, the trusts and Watkins conclude that PBC has recovered more than was due and that it now owes them \$189,111.

[¶34] The trusts and Watkins do not provide any explanation or evidentiary support for their calculations, either in their motion or in their briefs to this court. In fact, their motion did not attach any evidence whatsoever. Neither the evidence in the record nor the parties' briefs provides any guidance for how the calculations are to be performed given the correct loan amount. Rather, the record contains only evidence of how the bank applied interest against the incorrect amount; when using the correct amount, only the results of the parties' respective calculations are given.

[¶35] The record before us does not establish the amount of any surplus or that such a surplus exists. We have already held that the original amount of the loan as specified in the Note, Security Agreement, and Guaranty Agreement was \$1,007,000, not \$1,700,000, and we thus hold that the trusts and Watkins have established that they were entitled to summary judgment on their first request for declaratory relief, namely a legal declaration that "the . . . Note . . . was for the original principal amount of \$1,007,000; and not \$1,700,000." The trial court erred in denying this relief on the basis of the pleadings and record before it. Because the record provides no definitive basis for calculating the amount due at the time of the foreclosure sale or at the date of the trial court's judgment, however, the trial court did not err in denying the other declaratory relief requested. We note that even if the trusts and Watkins had entirely prevailed on their summary judgment motion in the trial court, the rules of civil procedure would have permitted PBC an opportunity to assert the equitable claims that it referenced for the first time in its appellate briefing. See

TEX. R. CIV. P. 63. Accordingly, we will remand the case to the trial court for further proceedings consistent with this opinion.

Conclusion

[¶36] The amount due under the Note, Security Agreement, and Guaranty Agreement was determined by the written words therein, not the numerals. The judgment of the trial court regarding PBC's claims for affirmative relief is therefore reversed. We also reverse the judgment to the extent that it denied summary judgment to the trusts and Watkins on their first claim for declaratory relief. Further, because the trusts and Watkins were entitled to judgment on that claim, we render judgment that the principal amount of the loan as specified in the Note was \$1,007,000.00.

We remand the case to the trial court for further proceedings consistent with this opinion.

Questions:

1. What sorts of policy concerns could possibly justify this holding? Doesn't the court care what actually happened? Is this case's result consistent with the parties' intentions at the time of contract formation? Either party's intentions?
2. The rule the court follows appears in UCC Article 3 and by its terms applies only to negotiable instruments. An instrument is negotiable when it (1) is "an unconditional promise or order to pay a fixed amount of money," (2) "is payable to bearer or order" when issued or when it comes into possession of a subsequent holder, (3) "is payable on demand or at a definite time," and (4) does not contain any other promises or instruction that the person paying the money must do. UCC § 3-104. A common bank check is a negotiable instrument. Finance notes, such as for cars, or equipment, are often also negotiable. Why is the rule the court follows particularly appropriate for a negotiable instrument?
3. The court calls the other contracts at issue in this case "non-negotiable instruments." E.g., ¶17. The UCC actually defines "instrument": "'Instrument' means a negotiable instrument." UCC § 3-104. The Texas code includes this definition. Does that undercut *Tips*?
4. The "instrument" at issue in the *Guthrie* case was a non-negotiable note. Same thing in *Keilman* and *Duvall*. Should that distinguish them from this case? Why is a guaranty not a negotiable instrument? How is a guaranty different than a note?

5. The word *parol* is an older “Law French” term meaning words or speech. J.H. Baker, *Manual of Law French* 165 (1990). Its meaning has expanded to include something like “anything that is not written in the document at issue.” This might be spoken words but it also might be writing in other documents not formally connected to the contract or other actions of the parties. A letter written between the parties during negotiations, for instance, would be “parol” as the word is often used.

6. What should be your advice to drafters after reading this case?

7. Is the creditor out of luck, here? Should it have asked for another form of relief?

Caution!— The Parol Evidence Rule. Most of the cases in this section mention a rule of contract law called the “parol evidence rule.” This is a different rule than the plain meaning rule, though some courts and commentators confusingly use the “parol evidence rule” label for both the parol evidence rule and the plain meaning rule. The two rules have very different functions within the law. Be careful not to confuse them.

The parol evidence rule applies when the parties have chosen to put their contract in a writing. Putting a contract in writing is a significant act, and the parol evidence rule takes account of that significance. The rule attaches great importance to this document. The basic terms of the parol evidence rule are simply stated:

If the parties have agreed that a written document will be the final expression of their agreement, then the document cannot be contradicted by evidence of (or from) any prior or contemporaneous promise or agreement.

If the parties have agreed that the document is complete, then it cannot be supplemented by any prior or contemporaneous promise or agreement.

Though the “parol” evidence rule employs the word “parol,” consistently with the expanded meaning of that word the “parol evidence rule” applies to any (and all) prior or contemporaneous promise or agreement, including other written ones, that contradict or supplement the specified written contract. In this usage, the document designated by the parties controls, and everything else is just “words.” The the parol evidence rule polices the content of a contract by saying which words are included in it. The parol evidence rule is not about the meaning of those words; that is determined by the plain meaning rule and the other rules you learn in this section. The parol evidence rule is about what words are included in the contract at all, and the parol evidence rule applies any time the parties have put their agreement in writing.

The parol evidence rule is harder to apply than to state, for various reasons we will talk about in Part I.B, which covers the rule. However, you should know that courts often refer explicitly or implicitly to the parol evidence rule when they discuss the plain meaning rule, the one that governed the *Tips* case. Courts also use language that sometimes makes

you think they may be referring to both rules (*Tips* ¶14, for instance); you will have to determine from context which one they are applying (in *Tips*, I think it's plain meaning).

Many of the policy concerns that animate the plain meaning rule also support the parol evidence rule. Sometimes the courts even mix the two rules together. In fact, judicial statements about the parol evidence rule are famously confusing. Let the language above describing the parol evidence rule be your guide, put yourself in information-gathering mode only on the parol evidence rule for now, and we will try to sort it out when we get to it. For now, remember this: The parol evidence rule does not address the meaning of words; it is not about ambiguity and what language means. The parol evidence rule is irrelevant to those issues.

Aside—Canons of Construction and Plain Meaning

Some rules of interpretation seem to be pretty universal. For example, rules written down by Rabbi Yishmael around 200 C.E. for interpreting Jewish Law indicate that “a matter is elucidated from its context.” As an example, one of the Ten Commandments is “thou shalt not steal.” This is considered a capital offense in Jewish Law because it falls between two other capital offenses—“thou shalt not kill” and “thou shalt not commit adultery.” Because only one kind of theft in Jewish law could be a capital offense—kidnapping a fellow Jew and treating him as a slave—Jewish legal scholars conclude that “thou shalt not steal” in the Ten Commandments refers only to kidnapping.* Which of the following maxims of contract interpretation is most like “a matter is elucidated from its context”?

Expressio unius exclusio alterius est: The expression of one is the exclusion of the other. In *Ulmer v. Harsco Corp.*, the court considered whether severance payments had to be paid to employees who were terminated as part of the sale of the business. The employer’s “Severance Pay Policy” or “Plan” stated when severance would be paid and specified exceptions. The Court reasoned:

In sum, while the language of the Plan is general, it is not ambiguous on its face. It clearly states that “where employment is terminated”—the language Harsco used to describe its action in its letter to employees—severance would be paid. Jt. App. at 449. Since the Plan gives several exemptions to this rule—“death, disability, retirement and military leave,” Jt. App. at 450—one may assume under the principle of *expressio unius exclusio alterius* that other exemptions such as going concern sales were not intended.

Ulmer v. Harsco Corp., 884 F.2d 98, 103-04 (3d Cir. 1989). For this and other reasons, the court reversed summary judgment in favor of the employer.

Noscitur a sociis: It is known from its associates. Under the doctrine of *noscitur a sociis*, “the meaning of a word or phrase may be ascertained by reference to the meaning of other

* Thanks to Michael Rothenberg, STCLH Class of ‘02, for the translation and explanation.

words and phrases with which it is associated.” *Wolfe v. Forbes*, 217 S.E.2d 899, 900 (W. Va. 1975).

United States Supreme Court Justice Antonin Scalia discussed the meaning of this rule by illustration: "If you tell me, 'I took the boat out on the bay,' I understand 'bay' to mean one thing; if you tell me, 'I put the saddle on the bay,' I understand it to mean something else." *A Matter of Interpretation*, (Princeton, New Jersey: Princeton University Press, 1997), p 26.

G.C. Timmis & Co. v. Guardian Alarm Co., 2003 WL 21399027 (Mich., June 18, 2003) (Young, J. dissenting).

Ejusdem generis: In applying this maxim, meaning is given to a general term in the following manner:

[T]he general term is restricted to include only things of the same kind, class, character, or nature as those specifically enumerated"; that is, because the listed items have a commonality, the general term is taken as sharing it.

In *A Matter of Interpretation* (Princeton, New Jersey: Princeton University Press, 1997), p. 26, United States Supreme Court Justice Antonin Scalia explains that the *ejusdem generis* canon of statutory construction stands for the proposition that when a text lists a series of items, a general term included in the list should be understood to be limited to items of the same sort. For instance, if someone speaks of using "tacks, staples, screws, nails, rivets, and other things," the general term "other things" surely refers to other fasteners.

Weakland v. Toledo Engineering Co., Inc., 656 N.W.2d 175, 178 & n.1 (Mich. 2003).

Under the doctrine of *ejusdem generis*, when a statutory clause specifically describes several classes of things and then includes "other things," the word "other" is interpreted as meaning "other such like." *People v. Davis*, 199 Ill.2d 130, 138, 262 Ill. Dec. 721, 766 N.E.2d 641, 645 (2002).

Applying the doctrine of *ejusdem generis* and strictly construing the container exemption, we determine a vehicle's glove compartment is not an "other container" under the container exemption. A glove compartment is fundamentally different from a case, firearm carrying box, or shipping box because those receptacles are portable whereas a glove compartment is a fixed area in the dashboard of a vehicle. Therefore, a glove compartment is not an "other container" similar to the ones enumerated in the container exemption.

People v. Cameron, 784 N.E.2d 438 (Ill. App. 4 Dist., 2003). *Ejusdem generis* is a subcategory of *noscitur a sociis*.

Omnia praesumuntur contra proferentem: Ambiguous terms must be construed against the drafter of the contract.

Because the contract as a whole can be reasonably interpreted to support either Mead's or ABB Power's position regarding the scope of the indemnity clause, we conclude that the contract is ambiguous as to this issue. Under Ohio law, "[a]mbiguous contractual language will be construed against the drafter of the contract." *Lelux v. Chernick*, 119 Ohio App.3d 6, 694 N.E.2d 471, 473 (1997)

(citing *Cent. Realty Co. v. Clutter*, 62 Ohio St.2d 411, 406 N.E.2d 515, 517 (1980)). Because Mead drafted the contract, the ambiguity should be resolved in favor of ABB Power.

Mead Corp. v. ABB Power Generation, Inc., 319 F.3d 790, 798-99 (6th Cir. 2003).

Ut magis valeat quam pereat: “It is a fundamental rule that a contract must, if possible, be so construed as to effectuate the intention of the parties and to sustain the contract, *ut res magis valeat quam pereat*.” *Baker v. Baker*, 139 Ill. App. 217 (Ill. App. 1 Dist. 1908). “First, it is fundamental that an interpretation of a contract which results in termination of the contract is disfavored over one which affirms the existence of the contract.” *Simeone v. First Bank Nat. Ass’n*, 971 F.2d 103, 107 (8th Cir. 1992).

An operative intention is presumed:

We follow the established general rules that provisions of a contract must be so construed as to effectuate its spirit and purpose, that it must be considered as a whole and interpreted so as to harmonize and give meaning to all of its provisions, and that an interpretation which gives a reasonable meaning to all parts will be preferred to one which leaves a portion of it useless, inexplicable, inoperative, void, insignificant, meaningless, superfluous”

State of Ariz. v. U. S., 575 F.2d 855, 863 (Ct.Cl. 1978). This rule is an application of or at least is related to *ut magis valeat quam pereat*.

Specific terms control over conflicting general terms:

We have held that a contract will be construed most strongly against the party who drafted it. *Security State Bank of Basin v. Newton*, Wyo., 707 P.2d 173 (1985). We also have held that general terms and provisions in a contract yield to specific ones, if not reconcilable. *Flora Construction Company v. Bridger Valley Electric Association, Inc.*, Wyo., 355 P.2d 884 (1960). Applying these rules, we find that the specific typewritten description of the collateral which the parties inserted into the printed form controls over the general description contained in the standard printed form.

Landen v. Production Credit Ass’n of Midlands, 737 P.2d 1325, 1328 (Wyo. 1987).

“When construing a contract on a printed form and there is an apparent conflict, writing prevails over printing, handwriting over typewriting, and typewriting over printing.” *In re Greives*, 81 B.R. 912, 953 (Bkrcty., N.D. Ind. 1987). Why do you suppose this is?

In contracts affecting the public interest, an interpretation favoring the public interest is preferred:

The court is mindful that “contracts affecting the public's interest generally are liberally interpreted to favor the public.” *Simon v. Farmland Indus., Inc.*, 505 F. Supp. 59, 61 (D.Kan.1980) (citing *United States v. Kan. Gas and Elec. Co.*, 215 F. Supp. 532, 542 (D.Kan.1963)). Here, the Agreement clearly affects the public interest.

The public, as consumers of cable television services, has an interest in paying reasonable rates for those services. Thus, the public interest is served when consumers are given choices about whom they can select to provide their cable service. Moreover, the public has an interest in avoiding the potential disruption of having their home wiring removed upon the voluntary termination of the incumbent provider's service and then, subsequently, having the new provider install its home run wiring. The FCC Report makes clear that these are stated purposes of the Telecommunications Act of 1996, the act under which the FCC Home Run Wiring Rules were promulgated. See e.g., FCC Report ¶ 36 ("[The Telecommunication Acts] was [sic] intended to promote consumer choice and competition by permitting subscribers to avoid the disruption of having their home wiring removed upon voluntary termination and to subsequently utilize that wiring for an alternative service[.]"). Accordingly, because the Agreement at issue affects the public interest, the court will, where appropriate, liberally construe the Agreement to favor the public.

Time Warner Entertainment Co., L.P. v. Atriums Partners, L.P., 232 F. Supp.2d 1257, 1265-66 (D.Kan. 2002).

Grammar and punctuation rules normally apply:

Absent the presentation of other evidence, the trial court resolves ambiguity by interpreting the contract using accepted canons of construction and traditional rules of grammar and punctuation.

Monette v. Tinsley, 975 P.2d 361 ¶ 13 (N.M. App. 1999).

PROBLEM 1: Jill agreed to assign and sell to Sam her ten-agent insurance office and business. The two obtained Jill's landlord's permission to transfer her lease. Sam's lawyer drew up an agreement for the sale, which both signed. The agreement stated in the recitals that its purpose was "to allow Sam to continue on in the business just as Jill had done." Handwritten above this recital and inserted after it were the words, "and to allow Jill to retire and reap the rewards of years of service in the insurance industry." A clause in the contract (immediately following a description of the leased premises) included in the sale and assignment

all computer hardware and software, files and databases, copy machines, cash registers, telephone system, and other personal property.

A separate provision of the agreement provided for transfer of software licenses. After Jill and Sam signed the sale agreement, relations soured. On the day set for the closing of the sale and the transfer of the premises, Sam arrived at the office to find that Jill had taken all of the furniture, including numerous file cabinets and their contents. Sam sued for an injunction ordering return of the files and furniture (or, for the furniture, in the alternative, damages). Sam argued that the files contained current customer records necessary for the

business to continue. Jill countered that she needed the files' contents in order to collect ongoing commissions on policy renewals, and that the files were not part of their deal.

What effect do the maxims have on this dispute?

The next case, *PG&E*, expresses a theory hostile to the plain meaning rule. Would this case have come out the same way under the plain meaning rule?

PACIFIC GAS AND ELECTRIC COMPANY v. G. W. THOMAS DRAYAGE &
RIGGING COMPANY, INC.

California Supreme Court (1968), 69 Cal. Rptr. 561, 69 Cal.2d 13

OPINION

TRAYNOR, C. J.

[¶1] Defendant appeals from a judgment for plaintiff in an action for damages for injury to property under an indemnity clause of a contract.

[¶2] In 1960 defendant entered into a contract with plaintiff to furnish the labor and equipment necessary to remove and replace the upper metal cover of plaintiff's steam turbine. Defendant agreed to perform the work "at [its] own risk and expense" and to "indemnify" plaintiff "against all loss, damage, expense and liability resulting from . . . injury to property, arising out of or in any way connected with the performance of this contract." Defendant also agreed to procure not less than \$50,000 insurance to cover liability for injury to property. Plaintiff was to be an additional named insured, but the policy was to contain a cross-liability clause extending the coverage to plaintiff's property.

[¶3] During the work the cover fell and injured the exposed rotor of the turbine. Plaintiff brought this action to recover \$25,144.51, the amount it subsequently spent on repairs. During the trial it dismissed a count based on negligence and thereafter secured judgment on the theory that the indemnity provision covered injury to all property regardless of ownership.

[¶4] Defendant offered to prove by admissions of plaintiff's agents, by defendant's conduct under similar contracts entered into with plaintiff, and by other proof that in the indemnity clause the parties meant to cover injury to property of third parties only and not to plaintiff's property.* Although the trial court observed that the language used was "the

* Although this offer of proof might ordinarily be regarded as too general to provide a ground for appeal (Evid. Code, § 354, subd. (a); Beneficial etc. Ins. Co. v. Kurt Hitke & Co. (1956) 46 Cal.2d 517, 522; Stickel

classic language for a third party indemnity provision" and that "one could very easily conclude that . . . its whole intendment is to indemnify third parties," it nevertheless held that the "plain language" of the agreement also required defendant to indemnify plaintiff for injuries to plaintiff's property. Having determined that the contract had a plain meaning, the court refused to admit any extrinsic evidence that would contradict its interpretation.

[¶5] When the court interprets a contract on this basis, it determines the meaning of the instrument in accordance with the ". . . extrinsic evidence of the judge's own linguistic education and experience." (3 Corbin on Contracts (1960 ed.) [1964 Supp. § 579, p. 225, fn. 56].) The exclusion of testimony that might contradict the linguistic background of the judge reflects a judicial belief in the possibility of perfect verbal expression. (9 Wigmore on Evidence (3d ed. 1940) § 2461, p. 187.) This belief is a remnant of a primitive faith in the inherent potency* and inherent meaning of words.†

[¶6] The test of admissibility of extrinsic evidence to explain the meaning of a written instrument is not whether it appears to the court to be plain and unambiguous on its face, but whether the offered evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible. [Omitted: a long list of citations.]

[¶7] A rule that would limit the determination of the meaning of a written instrument to its four-corners merely because it seems to the court to be clear and unambiguous, would either deny the relevance of the intention of the parties or presuppose a degree of verbal precision and stability our language has not attained.

[¶8] Some courts have expressed the opinion that contractual obligations are created by the mere use of certain words, whether or not there was any intention to incur such obligations.‡ Under this view, contractual obligations flow, not from the intention of the

v. San Diego Elec. Ry. Co. (1948) 32 Cal.2d 157, 162-164; Douillard v. Woodd (1942) 20 Cal.2d 665, 670), since the court repeatedly ruled that it would not admit extrinsic evidence to interpret the contract and sustained objections to all questions seeking to elicit such evidence, no formal offer of proof was required. (Evid. Code, § 354, subd. (b); Beneficial etc. Ins. Co. v. Kurt Hitke & Co., supra, 46 Cal.2d 517, 522; Estate of Kearns (1950) 36 Cal.2d 531, 537.)

* E.g., "The elaborate system of taboo and verbal prohibitions in primitive groups; the ancient Egyptian myth of Khern, the apotheosis of the words, and of Thoth, the Scribe of Truth, the Giver of Words and Script, the Master of Incantations; the avoidance of the name of God in Brahmanism, Judaism and Islam; totemistic and protective names in mediaeval Turkish and Finno-Ugrian languages; the misplaced verbal scruples of the 'Precieuses'; the Swedish peasant custom of curing sick cattle smitten by witchcraft, by making them swallow a page torn out of the psalter and put in dough . . . ' from Ullman, The Principles of Semantics (1963 ed.) 43. (See also Ogden and Richards, The Meaning of Meaning (rev. ed. 1956) pp. 24- 47.)

† " 'Rerum enim vocabula immutabilia sunt, homines mutabilia,' " (Words are unchangeable, men changeable) from Dig. XXXIII, 10, 7, § 2, de sup. leg. as quoted in 9 Wigmore on Evidence, op. cit. supra, § 2461, p. 187.

‡ "A contract has, strictly speaking, nothing to do with the personal, or individual, intent of the parties. A contract is an obligation attached by the mere force of law to certain acts of the parties, usually words, which ordinarily accompany and represent a known intent." (Hotchkiss v. National City Bank of New York

parties but from the fact that they used certain magic words. Evidence of the parties' intention therefore becomes irrelevant.

[¶9] In this state, however, the intention of the parties as expressed in the contract is the source of contractual rights and duties.* A court must ascertain and give effect to this intention by determining what the parties meant by the words they used. Accordingly, the exclusion of relevant, extrinsic, evidence to explain the meaning of a written instrument could be justified only if it were feasible to determine the meaning the parties gave to the words from the instrument alone.

[¶10] If words had absolute and constant referents, it might be possible to discover contractual intention in the words themselves and in the manner in which they were arranged. Words, however, do not have absolute and constant referents. "A word is a symbol of thought but has no arbitrary and fixed meaning like a symbol of algebra or chemistry, . . ." (Pearson v. State Social Welfare Board (1960) 54 Cal.2d 184, 195.) The meaning of particular words or groups of words varies with the ". . . verbal context and surrounding circumstances and purposes in view of the linguistic education and experience of their users and their hearers or readers (not excluding judges). . . . A word has no meaning apart from these factors; much less does it have an objective meaning, one true meaning." (Corbin, *The Interpretation of Words and the Parol Evidence Rule* (1965) 50 Cornell L.Q. 161, 187.) Accordingly, the meaning of a writing ". . . can only be found by interpretation in the light of all the circumstances that reveal the sense in which the writer used the words. The exclusion of parol evidence regarding such circumstances merely because the words do not appear ambiguous to the reader can easily lead to the attribution to a written instrument of a meaning that was never intended. [Citations omitted.]" (Universal Sales Corp. v. California Press Mfg. Co., *supra*, 20 Cal.2d 751, 776 (concurring opinion); see also, e.g., Garden State Plaza Corp. v. S. S. Kresge Co. (1963) 78 N.J. Super. 485; Hurst v. W. J. Lake & Co. (1932) 141 Ore. 306, 310; 3 Corbin on Contracts (1960 ed.) § 579, pp. 412-431; Ogden and Richards, *The Meaning of Meaning*, *op.cit supra* 15; Ullmann, *The Principles of Semantics*, *supra*, 61; McBaine, *The Rule Against Disturbing Plain Meaning of Writings* (1943) 31 Cal.L.Rev. 145.)

[¶11] Although extrinsic evidence is not admissible to add to, detract from, or vary the terms of a written contract, these terms must first be determined before it can be decided whether or not extrinsic evidence is being offered for a prohibited purpose. The fact that the terms of an instrument appear clear to a judge does not preclude the possibility that the parties chose the language of the instrument to express different terms. That possibility is not limited to contracts whose terms have acquired a particular meaning by trade

(S.D.N.Y. 1911) 200 F. 287, 293. See also C. H. Pope & Co. v. Bibb Mfg. Co. (2d Cir. 1923) 290 F. 586, 587; see 4 Williston on Contracts (3d ed. 1961) § 612, pp. 577-578, § 613, p. 583.)

* "A contract must be so interpreted as to give effect to the mutual intention of the parties as it existed at the time of contracting, so far as the same is ascertainable and lawful." (Civ. Code, § 1636; see also Code Civ. Proc., § 1859; Universal Sales Corp. v. California Press Mfg. Co. (1942) 20 Cal.2d 751, 760; Lemm v. Stillwater Land & Cattle Co. (1933) 217 Cal. 474, 480.)

usage,* but exists whenever the parties' understanding of the words used may have differed from the judge's understanding.

[¶12] Accordingly, rational interpretation requires at least a preliminary consideration of all credible evidence offered to prove the intention of the parties.[†] (Civ. Code, § 1647; Code Civ. Proc., § 1860; see also 9 Wigmore on Evidence, op. cit. supra, § 2470, fn. 11, p. 227.) Such evidence includes testimony as to the "circumstances surrounding the making of the agreement . . . including the object, nature and subject matter of the writing . . ." so that the court can "place itself in the same situation in which the parties found themselves at the time of contracting." (Universal Sales Corp. v. California Press Mfg. Co., supra, 20 Cal.2d 751, 761; Lemm v. Stillwater Land & Cattle Co., supra, 217 Cal. 474, 480-481.) If the court decides, after considering this evidence, that the language of a contract, in the light of all the circumstances, "is fairly susceptible of either one of the two interpretations contended for . . ." (Balfour v. Fresno C. & I. Co. (1895) 109 Cal. 221, 225; see also, Hulse v. Juillard Fancy Foods Co., supra, 61 Cal.2d 571, 573; Nofziger v. Holman, supra, 61 Cal.2d 526, 528; Reid v. Overland Machined Products, supra, 55 Cal.2d 203, 210; Barham v. Barham (1949) 33 Cal.2d 416, 422-423; Kenney v. Los Feliz Investment Co. (1932) 121 Cal.App. 378, 386-387), extrinsic evidence relevant to prove either of such meanings is admissible.[‡]

[¶13] In the present case the court erroneously refused to consider extrinsic evidence offered to show that the indemnity clause in the contract was not intended to cover injuries to plaintiff's property. Although that evidence was not necessary to show that the indemnity clause was reasonably susceptible of the meaning contended for by defendant, it was nevertheless relevant and admissible on that issue. Moreover, since that clause was reasonably susceptible of that meaning, the offered evidence was also admissible to prove

* Extrinsic evidence of trade usage or custom has been admitted to show that the term "United Kingdom" in a motion picture distribution contract included Ireland (*Ermolieff v. R.K.O. Radio Pictures, Inc.* (1942) 19 Cal.2d 543, 549-552); that the word "ton" in a lease meant a long ton or 2,240 pounds and not the statutory ton of 2,000 pounds (*Higgins v. California Petroleum etc. Co.* (1898) 120 Cal. 629, 630-632); that the word "stubble" in a lease included not only stumps left in the ground but everything "left on the ground after the harvest time" (*Callahan v. Stanley* (1881) 57 Cal. 476, 477-479); that the term "north" in a contract dividing mining claims indicated a boundary line running along the "magnetic and not the true meridian" (*Jenny Lind Co. v. Bower* (1858) 11 Cal. 194, 197-199) and that a form contract for purchase and sale was actually an agency contract. (*Body-Steffner Co. v. Flotill Products* (1944) 63 Cal.App.2d 555, 558-562). See also Code Civ. Proc., § 1861; Annot., 89 A.L.R. 1228; Note (1942) 30 Cal. L. Rev. 679.)

[†] When objection is made to any particular item of evidence offered to prove the intention of the parties, the trial court may not yet be in a position to determine whether in the light of all of the offered evidence, the item objected to will turn out to be admissible as tending to prove a meaning of which the language of the instrument is reasonably susceptible or inadmissible as tending to prove a meaning of which the language is not reasonably susceptible. In such case the court may admit the evidence conditionally by either reserving its ruling on the objection or by admitting the evidence subject to a motion to strike. (See Evid. Code, § 403.)

[‡] Extrinsic evidence has often been admitted in such cases on the stated ground that the contract was ambiguous (e.g., *Universal Sales Corp. v. California Press Mfg. Co.*, supra, 20 Cal.2d 751, 761). This statement of the rule is harmless if it is kept in mind that the ambiguity may be exposed by extrinsic evidence that reveals more than one possible meaning.

that the clause had that meaning and did not cover injuries to plaintiff's property.* Accordingly, the judgment must be reversed. * * * *

The judgment is reversed.

Peters, J., Mosk, J., Burke, J., Sullivan, J., and Peek, J., fn.* concurred.

McComb, J., dissented.

* The court's exclusion of extrinsic evidence in this case would be error even under a rule that excluded such evidence when the instrument appeared to the court to be clear and unambiguous on its face. The controversy centers on the meaning of the word "indemnify" and the phrase "all loss, damage, expense and liability." The trial court's recognition of the language as typical of a third party indemnity clause and the double sense in which the word "indemnify" is used in statutes and defined in dictionaries demonstrate the existence of an ambiguity. (Compare Civ. Code, § 2772, "Indemnity is a contract by which one engages to save another from a legal consequence of the conduct of one of the parties, or of some other person," with Civ. Code, § 2527, "Insurance is a contract whereby one undertakes to indemnify another against loss, damage, or liability, arising from an unknown or contingent event." Black's Law Dictionary (4th ed. 1951) defines "indemnity" as "A collateral contract or assurance, by which one person engages to secure another against an anticipated loss or to prevent him from being damnified by the legal consequences of an act or forbearance on the part of one of the parties or of some third person." Stroud's Judicial Dictionary (2d ed. 1903) defines it as a "Contract . . . to indemnify against a liability" One of the definitions given to "indemnify" by Webster's Third New International Dict. (1961 ed.) is "to exempt from incurred liabilities.")

Plaintiff's assertion that the use of the word "all" to modify "loss, damage, expense and liability" dictates an all inclusive interpretation is not persuasive. If the word "indemnify" encompasses only third-party claims, the word "all" simply refers to all such claims. The use of the words "loss," "damage," and "expense" in addition to the word "liability" is likewise inconclusive. These words do not imply an agreement to reimburse for injury to an indemnitee's property since they are commonly inserted in third-party indemnity clauses, to enable an indemnitee who settles a claim to recover from his indemnitor without proving his liability. (*Carpenter Paper Co. v. Kellogg* (1952) 114 Cal.App.2d 640, 651. Civ. Code, § 2778, provides: "1. Upon an indemnity against liability . . . the person indemnified is entitled to recover upon becoming liable; 2. Upon an indemnity against claims, or demands, or damages, or costs . . . the person indemnified is not entitled to recover without payment thereof; . . .")

The provision that defendant perform the work "at his own risk and expense" and the provisions relating to insurance are equally inconclusive. By agreeing to work at its own risk defendant may have released plaintiff from liability for any injuries to defendant's property arising out of the contract's performance, but this provision did not necessarily make defendant an insurer against injuries to plaintiff's property. Defendant's agreement to procure liability insurance to cover damages to plaintiff's property does not indicate whether the insurance was to cover all injuries or only injuries caused by defendant's negligence.

Questions:

1. Traynor says that when a court interprets a contract based on its plain meaning, it determines meaning according to “the extrinsic evidence of the judge’s own linguistic education and experience.” What does Traynor mean by that?
2. Is “perfect verbal expression” impossible? Is it a remnant of a “primitive faith in the inherent potency and inherent meaning of words”? Is plain meaning possible? Why or why not?
3. Can you explain, given Traynor’s view of why words have meaning, how Traynor knows even without extrinsic evidence that the word *indemnify* is reasonably susceptible to the meaning that excluded coverage of injuries to the plaintiff’s property? Evidence of what kind of meaning for the word *indemnify* would be excluded under Traynor’s view?
4. Would Traynor accept evidence that the word *indemnify* meant that the defendant was supposed to pay for a backpacking trip in the Himalayas?
5. To whom was the contract written? Should that make a difference?
6. To which of the following theories of theories of meaning does Traynor subscribe?
 - i) *Reference to Reality*—the meaning of a word is the thing to which it refers. The paradigm type of word for this theory is, as one would expect, the noun, perhaps even the proper noun. The words “Mt. Rushmore” obviously refer, and the reference—the connection between the word and the object to which the word refers—gives the words meaning. This theory has difficulty explaining verbs and adverbs, and even more difficulty with pronouns, articles (i.e., “a” or “the”), and numbers.
 - ii) *Reference to a Concept*—the meaning of a word is the concept to which the word refers. This theory is a refinement on the first theory. This theory appears in one of two forms:
 - a) *Mental Concept*—the word refers to a mental concept existing in the mind of the person using the word. A great number of people (who haven’t thought about the issue very much) hold with this theory. Communication under this theory is to convey the concepts in one’s mind to the mind of another by means of words. That awful phrase “meeting of the minds” probably rests on this theory. If this theory were true, could we speak truth? Worse, how would we learn to speak?
 - b) *Metaphysical Concept*—the word refers to a concept existing outside the mind of the person using the word. Folks who thought about mental concepts and words a great deal (such as Plato, perhaps) realized that a person’s words still have meaning, even very clear meaning, even when that person is unconscious (when no mental concepts might exist and at least when no one in this world has access to them). To hold to the “Reference to

a Concept" theory in circumstances such as these, these thinkers often begin to talk as if concepts to which words refer exist outside the mind. It doesn't make sense to talk of "where" these concepts exist, because they are not physical. Instead, they are metaphysical, we say, meaning that what is physical shows that they exist but that they do not exist in the physical sphere.

iii) *Reference to a Universal Mental Language*—the meaning of a word is hardwired into us biologically. This may sound odd at first, but some thinkers believe that humans are hardwired for language. Under this theory, the language capacity is already there, and the particular language we speak just plugs itself into the slots in our already prepared minds. We understand each other because we have the more or less similar, already prepared slots in all of our minds. The slots themselves form a sort of universal language, and when we learn a language, we are merely translating the slots into spoken words. Some work in artificial intelligence rests on this theory.

iv) *Meaning is Use*—the meaning of a word is its use in a regular linguistic activity between at least two people. This theory considers that words are not qualitatively different from other actions, though speaking a language is more complex than most other actions. Thinkers who hold with this theory point out that in order for a word to have meaning, that which gives it meaning must be available to both the speaker and the hearer—it must be public. Only our regular use of words and actions in response to them is public in that sense and available to provide meaning to words.

7. Would it surprise you to hear that courts have argued over the meaning and effect of *PG&E*? The court in *Trident Center v. Connecticut General Life Ins. Co.*, 847 F.2d 564 (9th Cir. 1988), said,

Under *Pacific Gas*, it matters not how clearly a contract is written, nor how completely it is integrated, nor how carefully it is negotiated, nor how squarely it addresses the issue before the court: the contract cannot be rendered impervious to attack by parol evidence. If one side is willing to claim that the parties intended one thing but the agreement provides for another, the court must consider extrinsic evidence of possible ambiguity. If that evidence raises the specter of ambiguity where there was none before, the contract language is displaced and the intention of the parties must be divined from self-serving testimony offered by partisan witnesses whose recollection is hazy from passage of time and colored by their conflicting interests.

A California court of appeals countered in *ACL Technologies, Inc. v. Northbrook Property & Casualty Ins. Co.*, 22 Cal.Rptr. 2d 206, 219 (Cal. App. 4 Dist. 1993),

With all due respect to the critics of *Pacific Gas*, the case is not an endorsement of linguistic nihilism. Despite what might be called its "deconstructionist" dictum, the actual holding of the case is a fairly modest one: courts should allow parol evidence to explain special meanings which the individual parties to a contract may have given certain words.

Is either one an adequate characterization of *PG&E*?

Note: What Kind of Intent Are We After?

Sometimes extrinsic evidence is necessary no matter what. When it is, should we then follow the parties' subjective intent or some more objective (plain?) meaning? *In re Soper's Estate*, 264 N.W. 427 (Minn. 1935), reported the following facts: Ira Soper married Adeline Westphal in October 1911. He lived with her in Louisville, Kentucky, until August 1921, when he suddenly disappeared. Their marriage was not always happy. Soper would go on "drunken sprees." He had gone on a spree just prior to disappearing. But, just prior to disappearing, he had written suicide notes to his wife: "If there is any hereafter may meet you again." Soper's car was found at the bank of a nearby canal along with his hat and portions of his clothing. Pinned to his business card and left in his car was a note reading, "This belongs to Mrs. Soper."

In fact, Soper went to Canada and then Minneapolis, where he called himself John W. Young. He started a fuel company, the Young Fuel Company, with another fellow, Karstens. In May 1927, he purported to marry Gertrude Whitby, a widow, and they lived together as husband and wife until Soper-Young really did commit suicide in 1932. Ms. Whitby had believed Soper to be a widower when they met.

After Soper married Whitby, he and Karstens created a joint stock insurance plan under which one was to buy the stock of the other if the other should die. The payments were to come from the insurance plan, and they were to be paid to the surviving "wife" of the other, if living. Soper referred to Whitby as his wife during the negotiations. The premiums were paid by the company as an expense.

When Soper died, the insurance trustee paid the proceeds over to Ms. Whitby. At the time, no one involved knew of Adeline Westphal Soper. Several months elapsed before the real Mrs. Soper showed up. The administrator of Soper's estate then sued Ms. Whitby for return of the funds so that they could be awarded to the "wife." Who should win? There could only be one legal wife. Is there any way to identify "wife" without extrinsic evidence? For the record, the court let Whitby keep the money over a dissenting vote.

2. Substantive Presumptions

Sometimes public policy other than contract law is so influential that it requires that words of contract be construed other than the way we might (even reasonably) expect. What policy is at issue in this case? What affect does that policy have on the legal meaning of which words?

MONTGOMERY COUNTY HOSPITAL DISTRICT f/d/b/a Medical Center Hospital v.
Valarie BROWN
Supreme Court of Texas (1998), 965 S.W.2d 501

[¶1] The principal issue before us is whether at-will employment can be modified by nothing more than an employer's oral assurances that an employee whose work is satisfactory will not be terminated without good cause. We hold that an employer's oral statements do not modify an employee's at-will status absent a definite, stated intention to the contrary. * * * *

[¶2] For ten years Valarie Brown was employed by the Montgomery County Hospital District as laboratory systems manager for Medical Center Hospital. After her employment terminated, Brown brought this action against the District and its president and vice president (collectively, "the District") for breach of oral and written contracts of employment and deprivation of property and liberty interests protected by the Texas Constitution. The district court granted summary judgment for the District. The circumstances surrounding the termination of Brown's employment, vigorously disputed by the parties, are largely irrelevant to the contract issues before us. Given the conflict in the summary judgment record, we accept as true Brown's assertion that she did not voluntarily resign but was fired without good cause. We assume that Brown is not estopped by acceptance of her severance pay to assert that she was wrongfully terminated. And we take Brown's word that:

At the time I was hired as well as during my employment, I was told by [the Hospital administrator] that I would be able to keep my job at the Hospital as long as I was doing my job and that I would not be fired unless there was a good reason or good cause to fire me. This representation was important to me since I was going to have to relocate from Houston to the Conroe area if I accepted the position with the Hospital.

[¶3] The court of appeals held as a matter of law that the Hospital's employee manual was not an employment contract as Brown claimed, *Brown v. Montgomery County Hosp.*, 929 S.W.2d at 583 (Tex. App.-Beaumont 1996), and Brown has not appealed that ruling. But the appeals court held that fact questions subsisted concerning the existence of an oral employment contract, based on the hospital administrator's alleged assurances, that precluded summary judgment. 929 S.W.2d at 583-585. The court also held that such a contract was not, as a matter of law, barred by the Statute of Frauds, Tex. Bus. & Com. Code § 26.01. 929 S.W.2d at 584-585. Because the effect of an employer's oral assurances on at-will employment is an important and recurring issue, we granted the District's application for writ of error. * * * *

[¶4] For well over a century, the general rule in this State, as in most American jurisdictions, has been that absent a specific agreement to the contrary, employment may be terminated by the employer or the employee at will, for good cause, bad cause, or no cause at all. *Federal Express Corp. v. Deutschmann*, 846 S.W.2d 282, 283 (Tex.1993) (per

curiam); *Schroeder v. Texas Iron Works*, 813 S.W.2d 483, 489 (Tex.1991); *Winters v. Houston Chronicle Pub. Co.*, 795 S.W.2d 723, 723 (Tex.1990); *Sabine Pilot Serv., Inc. v. Hauck*, 687 S.W.2d 733, 734-35 (Tex.1985); *East Line & R.R.R. Co. v. Scott*, 72 Tex. 70, 10 S.W. 99, 102 (1888). The District argues that its assurances to Brown were too indefinite to constitute an agreement limiting the District's right to discharge Brown at will. We agree.

[¶5] A promise, acceptance of which will form a contract, “is a manifestation of intention to act or refrain from acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made.” Restatement (Second) of Contracts § 2(1) (1981). General statements like those made to Brown simply do not justify the conclusion that the speaker intends by them to make a binding contract of employment. For such a contract to exist, the employer must unequivocally indicate a definite intent to be bound not to terminate the employee except under clearly specified circumstances.

[¶6] General comments that an employee will not be discharged as long as his work is satisfactory do not in themselves manifest such an intent. Neither do statements that an employee will be discharged only for “good reason” or “good cause” when there is no agreement on what those terms encompass. Without such agreement the employee cannot reasonably expect to limit the employer's right to terminate him. An employee who has no formal agreement with his employer cannot construct one out of indefinite comments, encouragements, or assurances.

[¶7] This is the rule in other states. For example, in *Rowe v. Montgomery Ward & Co.*, 437 Mich. 627, 473 N.W.2d 268 (1991), the court held that a supervisor's assurance that employees would have their jobs “generally, as long as they generated sales and were honest” did not limit the employer's right to discharge an employee at will. *Id.* at 270. Noting that a decade earlier it had “joined the forefront of a nationwide experiment in which, under varying theories, courts extended job security to nonunionized employees,” the court retreated from earlier decisions in which it had been more inclined to find an employment agreement in general assurances made by the employer. *Id.* at 269. “[C]alling something a contract that is in no sense a contract cannot advance respect for the law,” the court wrote. *Id.* It concluded: “[O]ral statements of job security must be clear and unequivocal to overcome the presumption of employment at will.” *Id.* at 275.

[¶8] Likewise, in *Hayes v. Eateries, Inc.*, 905 P.2d 778 (Okla.1995), the court held that oral assurances that an employee “would be employed as long as he did an adequate job and/or performed his duties satisfactorily” did not constitute “a binding agreement that protected him from discharge except for ‘just cause’.” *Id.* at 782. The court explained:

Courts “must distinguish between carefully developed employer representations upon which an employee may justifiably rely, and general platitudes, vague assurances, praise, and indefinite promises of permanent continued employment.” Only when the promises are definite and, thus, of the sort which may be reasonably or justifiably relied on by the employee, will a contract claim be viable, not when the employee relies on only vague assurances that no reasonable person would

justifiably rely upon. There is, thus, an objective component to the nature of such a contract claim in the form of definite and specific promises by the employer sufficient to substantively restrict the reasons for termination.
Id. at 783 (citations omitted).

[¶9] There are scores of cases like these throughout the country, and courts in different jurisdictions have reached different conclusions, sometimes on the basis of the particular circumstances, and sometimes because of their view that oral, informal statements in the employment context should simply be given more effect. See generally Theresa Ludwig Kruk, Annotation, Right to Discharge Allegedly “At-Will” Employee as Affected by Employer’s Promulgation of Employment Policies as to Discharge, 33 A.L.R.4th 120 (1984). From our review of these cases we conclude that those we have cited are better reasoned.

[¶10] Consistent with our holding in the case, the court in *Byars v. City of Austin*, 910 S.W.2d 520, 523-524 (Tex.App.-Austin 1995, writ denied), held that an employee handbook’s description of usual disciplinary procedures were not “clear and specific” so as to modify an employment at will. Three other decisions of our intermediate courts that have dealt with statements similar to those made to Brown in this case did not consider whether the statements made were definite enough to constitute an enforceable contract. *Hardison v. A.H. Belo Corp.*, 247 S.W.2d 167 (Tex.Civ.App.-Dallas 1952, no writ); *Johnson v. Ford Motor Co.*, 690 S.W.2d 90 (Tex.App.-Eastland 1985, writ ref’d n.r.e.); *Morgan v. Jack Brown Cleaners, Inc.*, 764 S.W.2d 825 (Tex.App.-Austin 1989, writ denied). To the extent these cases can be read to reach a result contrary to our holding here, we disapprove them.

Accordingly, the judgment of the court of appeals is reversed and judgment is rendered for the District.

Questions:

1. If someone told you that “you will be able to keep your employment as long as you are doing your job and that you will not be fired unless there is a good reason or good cause to fire you,” would you reasonably believe that your employment could not be terminated for no reason at all?
2. If you answered “yes” to question 1 or believe that it is plausible to answer “yes” to question 1, under what rule can the court then hold as a matter of law that your reasonable belief does not matter? In other words, why did the court think it necessary to grant review in this case and issue an opinion?
3. Paragraph 9 suggests decisions are not uniform on this issue. Why is this case satisfactory or not as a matter of policy?

4. What is the role of words like *reasonably*, *justifiably*, *objective*, *definite*, and *specific* in paragraph 8?
5. What would Brown have to show that the hospital did in order to escape the holding in this case?
6. Was Brown deceived?
7. What policy would explain the traditional Japanese presumption of lifetime employment?
8. Can you think of any other examples of substantive interpretive presumptions? Why or why not? Consider: “[A] court can compel arbitration where there is an indisputably valid and enforceable arbitration provision and that arbitration provision can be interpreted to encompass the parties’ disputes.” *Severstal U.S. Holdings, LLC v. RG Steel, LLC*, 865 F. Supp. 2d 430, 439 (S.D.N.Y. 2012). Also consider this: “[B]ecause plea agreements’ constitutional and supervisory implications raise concerns over and above those present in the traditional contract context, in interpreting such agreements we hold the government to a greater degree of responsibility than the defendant . . . for imprecisions or ambiguities in the plea agreements. Ambiguities in a plea agreement are therefore construed against the government” *U.S. v. Bowman*, 634 F.3d 357, 360 (6th Cir. 2011) (internal quotations and citations omitted).

3. Usage, Custom, and Prior Practice

All contracts have context, and sometimes only a reference to the context can resolve a dispute over the meaning of contractual language. The doctrine in this section allows the court access to that context.

Herman FISHER v. CONGREGATION B’NAI YITZHOK
Pa. Superior Ct. (1955), 110 A.2d 881

OPINION BY HIRT, J.

[¶1] Plaintiff is an ordained rabbi of the orthodox Hebrew faith. He however does not officiate except on occasion as a professional rabbi-cantor in the liturgical service of a synagogue. The defendant is an incorporated Hebrew congregation with a synagogue in Philadelphia. Plaintiff, in response to defendant's advertisement in a Yiddish newspaper, appeared in Philadelphia for an audition before a committee representing the congregation. As a result, a written contract was entered into on June 26, 1950, under the terms of which plaintiff agreed to officiate as cantor at the synagogue of the defendant congregation "for the High Holiday Season of 1950", at six specified services during the month of September

1950. As full compensation for the above services the defendant agreed to pay plaintiff the sum of \$1,200.

[¶2] The purpose upon which the defendant congregation was incorporated is thus stated in its charter: "The worship of Almighty God according to the faith, discipline, forms and rites of the orthodox Jewish religion." And up to the time of the execution of the contract the defendant congregation conducted its religious services in accordance with the practices of the orthodox Hebrew faith. On behalf of the plaintiff there is evidence that under the law of the Torah and other binding authority of the Jewish law, men and women may not sit together at services in the synagogue. In the orthodox synagogue, where the practice is observed, the women sit apart from the men in a gallery, or they are separated from the men by means of a partition between the two groups. The contract in this case is entirely silent as to the character of the defendant as an orthodox Hebrew congregation and the practices observed by it as to the seating at the services in the synagogue. At a general meeting of the congregation on July 12, 1950, on the eve of moving into a new synagogue, the practice of separate seating by the defendant formerly observed was modified and for the future the first four rows of seats during religious services were set aside exclusively for the men, and the next four rows for the women, and the remainder for mixed seating of both men and women. When plaintiff was informed of the action of the defendant congregation in deviating from the traditional practice as to separate seating, he through his attorney notified the defendant that he, a rabbi of the orthodox faith, would be unable to officiate as cantor because "this would be a violation of his beliefs." Plaintiff persisted in the stand taken that he would not under any circumstances serve as cantor for defendant as long as men and women were not seated separately. And when defendant failed to rescind its action permitting men and women to sit together during services, plaintiff refused to officiate. It then was too late for him to secure other employment as cantor during the 1950 Holiday season except for one service which paid him \$100, and he brought suit for the balance of the contract price.

[¶3] The action was tried before the late Judge Fenerty, without a jury, who died before deciding the issue. By agreement the case was disposed of by the late President Judge Frank Smith "on the notes of testimony taken before Judge Fenerty." At the conclusion of the trial, counsel had stipulated that the judge need not make specific findings of fact in his decision. This waiver applied to the disposition of the case by Judge Smith. Nevertheless Judge Smith did specifically find that defendant, at the time the contract was entered into, "Was conducting its services according to the Orthodox Hebrew Faith." Judge Smith accepted the testimony of three rabbis learned in Hebrew law, who appeared for plaintiff, to the effect: "That Orthodox Judaism required a definite and physical separation of the sexes in the synagogue." And he also considered it established by the testimony that an orthodox rabbi-cantor "could not conscientiously officiate in a 'trefah' synagogue, that is, one that violates Jewish law"; and it was specifically found that the old building which the congregation left, "had separation in accordance with Jewish orthodoxy." The ultimate finding was for the plaintiff in the sum of \$1,100 plus interest. And the court entered

judgment for the plaintiff on the finding. In this appeal it is contended that the defendant is entitled to judgment as a matter of law.

[¶4] The finding for the plaintiff in this trial without a jury has the force and effect of a verdict of a jury and in support of the judgment entered by the lower court, the plaintiff is entitled to the benefit of the most favorable inferences from the evidence. *Jann v. Linton's Lunch*, 150 Pa. Superior Ct. 653, 29 A.2d 219. Findings of fact by a trial judge, sitting without a jury, which are supported by competent substantial evidence are conclusive on appeal. *Scott-Smith Cadillac Co., Inc. v. Rajeski*, 166 Pa. Superior Ct. 116, 70 A.2d 454.

[¶5] Although the contract is silent as to the nature of the defendant congregation, there is no ambiguity in the writing on that score and certainly nothing was omitted from its terms by fraud, accident or mistake. The terms of the contract therefore could not be varied under the parole evidence rule. *Bardwell v. The Willis Company*, 375 Pa. 503, 100 A.2d 102; *Mathers v. Roxy Auto Company*, 375 Pa. 640, 101 A.2d 680. Another principle controls the interpretation of this contract.

[¶6] There is sufficient competent evidence in support of the finding that this defendant was an orthodox congregation, which observed the rule of the ancient Hebrew law as to separate seating during the services of the High Holiday Season; and also to the effect that the rule has been observed immemorially and invariably by the defendant in these services, without exception. As bearing on plaintiff's bona fide belief that such was the fact, at the time he contracted with the defendant, plaintiff was permitted to introduce the declaration of Rabbi Ebert, the rabbi of the defendant congregation, made to him prior to signing of the contract, in which the rabbi said: "There always was a separation between men and women" and "there is going to be strict separation between men and women", referring to the seating in the new synagogue. Rabbi Lipschitz, who was present, testified that Rabbi Ebert, in response to plaintiff's question "Will services be conducted as in the old Congregation" replied "Sure. There is no question about that" referring to the prior practice of separate seating. The relationship of rabbi to the congregation which he serves does not create the legal relationship of principal and agent [meaning the rabbis' words were not legally binding on the congregation just because the Rabbi spoke them—Ricks]. * * * *

[¶7] In determining the right of recovery in this case the question is to be determined under the rules of our civil law, and the ancient provision of the Hebrew law relating to separate seating is read into the contract only because implicit in the writing as to the basis—according to the evidence—upon which the parties dealt. Cf. *Canovaro et al. v. Bros. of H. of St. Aug.*, 326 Pa. 76, 86, 191 A. 140. In our law the provision became a part of the written contract under a principle analogous to the rule applicable to the construction of contracts in the light of custom or immemorial and invariable usage. It has been said that: "When a custom or usage is once established, in absence of express provision to the contrary it is considered a part of a contract and binding on the parties though not mentioned therein, the presumption being that they knew of and contracted with reference to it": 1 Henry Pa. Evid., 4th Ed., § 203. Cf. Restatement, Contracts, § 248(2) and § 249.

In this case there was more than a presumption. From the findings of the trial judge supported by the evidence it is clear that the parties contracted on the common understanding that the defendant was an orthodox synagogue which observed the mandate of the Jewish law as to separate seating. That intention was implicit in this contract though not referred to in the writing, and therefore must be read into it. It was on this ground that the court entered judgment for plaintiff in this case.

Disposition

Judgment affirmed.

Questions:

1. Did Congregation Bnai Yitzhok agree to this provision?
2. Does this case set forth an exception to the plain meaning rule?
3. Did the rabbi agree to this provision?

Uniform Commercial Code § 1-303

Questions:

1. Can a single occurrence prove a course of dealing? A course of performance?
2. If express terms of an agreement and any applicable course of performance, course of dealing, or usage of trade conflict, which wins?

RALPH'S DISTRIBUTING CO. v. AMF, INC.
U.S. Ct. App., 8th Cir. (1981), 667 F.2d 670

[¶1] Ralph's Distributing Company appeals from the decision of the district court granting AMF's motion for summary judgment against Ralph's claim of breach of contract. We reverse because sufficient issues of material fact have been raised to preclude summary judgment.

I.

[¶2] Ralph's entered into a franchise agreement with AMF in May, 1968, to become a wholesale distributor of Ski-Daddlers.* The parties executed an identical franchise

* Prior to April, 1972, companies owned by AMF manufactured and marketed two lines of snowmobiles. The AMF Western Tool Division manufactured and marketed AMF Ski-Daddler snowmobiles. Harley-Davidson

agreement in June, 1969. The franchise agreements were accompanied by letters designating Ralph's sales territory for the upcoming snowmobile season. In May, 1970, the franchise agreements were incorporated by reference in a letter from AMF extending the contract. The letter again included a designation of Ralph's sales territory. No further writings were executed, but the parties continued to operate in accordance with the provisions of the 1968 and 1969 franchise agreements through the 1971-1972 snowmobile season.

[¶3] As a wholesale distributor, Ralph's bought Ski-Daddlers directly from AMF and then resold them to dealers in its designated territory for resale to the public. The Ski-Daddler program was unsuccessful and, during the 1971-1972 season, AMF decided to discontinue production of that line and to consolidate all future snowmobile manufacturing and marketing activities in Harley-Davidson. As a result of this decision, AMF began to sell its remaining inventory of Ski-Daddlers directly to Harley-Davidson dealers, bypassing Ralph's and other Ski-Daddler wholesale distributors.

[¶4] Ralph's brought suit against AMF, alleging that AMF's direct sales to Harley-Davidson dealers in Ralph's territory violated its contractual right to be the exclusive distributor of Ski-Daddler snowmobiles in its designated territory. Ralph's advanced three alternative theories in support of its claim: (1) that by including the designated sales territory in the franchise agreements, the parties intended to make Ralph's the sole distributor in that territory; (2) that even if the parties did not agree to include an exclusivity term in the initial agreement, they did so in subsequent oral modifications of the 1968-1969 franchise agreements; and (3) that in any event, an exclusivity provision should be implied in law by the court.* AMF moved for summary judgment on Ralph's claims. The district court rejected each of the theories advanced by Ralph's and granted AMF's motion for a summary judgment.

II.

[¶5] Summary judgment should be granted only if the pleadings, stipulations, affidavits and admissions show that there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. * * * * All evidence must be viewed in the light most favorable to the party opposing the motion. * * * Applying these standards to Ralph's breach of contract claim, we cannot agree that AMF has demonstrated that there is no genuine issue as to any material fact concerning Ralph's first two theories of recovery. * *

Motor Company, Inc., manufactured and marketed Harley-Davidson snowmobiles. Ralph's sold only Ski-Daddlers.

* * * * Under Iowa law, a contractual term is implied in law only when such implication is a legal necessity to carry out the contract and when it can be assumed that it would have been included in the agreement if the parties had considered it. *Fashion Fabrics of Iowa, Inc. v. Retail Investors Corp.*, 266 N.W.2d 22, 28 (Iowa 1978). The district court, applying this test, held that no exclusivity term should be implied in law. We find no error in this action.

[¶6] The trial court * * * found that even if Ralph's proffered parol evidence is considered, no question of fact is raised as to the parties' intention to include an exclusivity term. This finding is clearly erroneous. Fed.R.Civ.P. 52(a).

[¶7] The following course of performance and usage of trade evidence supports Ralph's claim that, pursuant to the franchise agreement, it was to be the sole distributor of Ski-Daddlers in its designated territory.* Ralph's alleged in its affidavit that it expended substantial funds on racing and other promotional activities in the expectation that neither AMF nor other distributors would sell Ski-Daddler snowmobiles in its exclusive territory. Three AMF employees or former employees testified in depositions that it was their understanding that once AMF designated a distributor for a territory, the company would not assign other distributors to the same area, and that the designated distributor was entitled to believe that AMF would not assign other distributors to his sales market.†

* This testimony has aspects of both course of performance and usage of trade. Course of performance evidence is admissible to establish the meaning the parties attached to contractual terms, as evidenced by their actions in carrying out the contract. Iowa Code § 554.2208 and Uniform Commercial Code Comment 1; White & Summers, Uniform Commercial Code, § 2-10 at 87 (2d ed. 1980). Usage of trade evidence is admissible to furnish background and give meaning to the contractual terms used by the parties as evidenced by past use of the language in the trade generally. Iowa Code § 554.1205 and Uniform Commercial Code Comment 4; Kirst, Usage of Trade and Course of Dealing: Subversion of the UCC Theory, 1977 U.Ill.L.F. 811, 814-840 (1977).

† For example, Charles Merical, a Ski-Daddler sales representative during the period in question here, stated during his deposition:

Q. Now, it does state in your letter, and I am now reading from it, "Your (Ralph's) territory will consist of the complete State of Iowa, Kansas, Missouri and the counties in Nebraska east of a line and including: Knox, Antelope, Boone, Nance, Merrick, Hamilton, Clay and Nuckolls."

Now, do you know how that territory was determined, how it was awarded, or whatever the phrase would be?

A. Well, I think basically areas that the distributor covered in his other products.

Q. And, also, that would not be inconsistent with territory previously awarded to someone else?

A. Yes.

Q. Would it be a fair statement that you typically did not have two distributors covering the same territory?

A. Yes.

Q. Would it also be a fair statement that you typically did not overlap territories either?

A. That's correct.

Q. From the company's point of view, what did this territory designation mean? As you understood the company designation, were you to abide by this in some manner?

A. If it was in writing that the distributor was given these territories, then you know, I probably generally would not try to overlap them at all.

Q. And you would not also set up another distributor in that same territory for that line of products?

A. Generally not.

Joseph Puglisi, currently an AMF vice president and, at the time in controversy here, director of marketing for Ski-Daddler snowmobiles, testified during his deposition:

Q. Without terminating a distributorship agreement, was it AMF's understanding, your understanding, that you could not establish another dealer or sell yourself in that territory?

A. I think it would have to be classified as an exception. No. The understanding would be that that distributor had a responsibility in that territory.

Ralph's also stated that many aspects of its distributorship were not covered in the franchise agreements including, for example, racing and other promotional activities, as well as the exclusivity requirement. Harold Whitten, a former division vice president at AMF, conceded in his deposition that AMF "encouraged" and "expected" distributors to engage in promotional activities such as racing despite the absence of such a requirement in the franchise agreements.

[¶8] Furthermore, after AMF entered into the arrangement with Harley-Davidson to market Ski-Daddler snowmobiles, AMF began to give rebates to Ski-Daddler distributors for each Ski-Daddler sold by Harley-Davidson dealers in the designated territories of those distributors. Ralph's argues this rebate plan was to compensate distributors for invasion of their exclusive territories.

[¶9] Finally, immediately after AMF entered into the agreement with Harley-Davidson, Ralph's protested the alleged breach of contract. It stated in its affidavit that other distributors raised similar complaints.

[¶10] Taking these statements in the light most favorable to Ralph's and giving it to the benefit of all reasonable inferences, we conclude that there is a genuine issue as to whether the parties intended to include an exclusivity term.

[¶11] Ralph's second theory for recovery is that if the contracts, when executed, did not make it the sole distributor, the franchise agreements were subsequently modified to include an exclusivity term. * * * Taking [the] * * * evidence in the light most favorable to Ralph's, we conclude that the evidence also creates a genuine issue as to whether the franchise agreements were modified subsequent to execution to include an exclusivity term.

[¶12] For these reasons, the district court erred in granting summary judgment against Ralph's. Accordingly, we reverse and remand for proceedings consistent with this opinion.

Q. Would that distributor have been entitled to believe that AMF would not appoint another distributor in that territory?

A. I think that's correct.

Q. Would he be entitled to believe that AMF would not become his competitor in that territory and start selling direct or creating their own dealers in that territory?

A. I think that would be an interpretation, yes.

Q. Was that your understanding?

A. Yes.

For purposes of a summary judgment motion, this testimony by Puglisi is sufficient to support a finding that the franchise agreements may have included an exclusivity term even though he also stated elsewhere in his deposition that the agreements did not contain such a provision.

Questions:

1. Which verb best describes the exclusivity term's relationship to the writing of the parties? (A) explain, (B) supplement, or (C) qualify?
2. How did AMF commit to exclusivity?
3. Is this case good policy? Why or why not?

LINCOLN BIG THREE, INC. v. W.G. "Bill" THOMAS
La. Ct. App. (1983), 444 So. 2d 171

[¶1] This appeal is from a judgment of the trial court which dismissed plaintiff's suit seeking rental and replacement costs of cylinders belonging to plaintiff, delivered to and allegedly unreturned by defendant. Plaintiff appealed.

[¶2] This is a suit termed a suit on open account arising from the sale of oxygen and acetylene by plaintiff, Lincoln Big Three, Inc. (Lincoln), to the defendant, W.G. "Bill" Thomas, B.A. Favret and B.T. Oilfield Services, Inc. (B.T.). Plaintiff stipulated the dismissal of the individual defendants and proceeded only against the corporation, B.T.

[¶3] Lincoln is in the business of selling welding supplies, and B.T. was engaged in the fabrication business requiring the use of welding supplies including oxygen and acetylene gas. The gases were sold in cylinders owned by Lincoln. The cylinders were rented to the customer with Lincoln retaining ownership. The dispute giving rise to this lawsuit concerns cylinders which Lincoln alleges were not returned and for which B.T. should have to pay under the terms of the contract between the parties.

[¶4] Until May of 1977, B.T. was engaged in the offshore and onshore oilfield fabrication business which was operated from various locations. In the course of business B.T. would request Lincoln to supply gases contained in cylinders. Lincoln would deliver the number of cylinders requested at designated places. If the filled cylinders were replacements for empty cylinders, the empty cylinders were picked up by Lincoln at the request of B.T. Lincoln would also pick up empty cylinders which were not replacement cylinders at the request of B.T. B.T. paid for the gas it used out of the cylinders and paid a daily rental for use of the cylinders from the day of delivery to the day Lincoln was called to pick up the cylinders. This was standard business practice, as well as the custom in the fabrication industry. In many cases cylinders were delivered and picked up at places other than the user's place of business. Lincoln had specially designed trucks for delivery and pick-up of its cylinders and had special forms and procedures established for recording pick-up of its cylinders.

[¶5] B.T. alleges that it notified Lincoln that it was shutting down its fabrication business, that it would not need any refilled cylinders, and that all the cylinders should be picked up by Lincoln. B.T. was never notified that the cylinders were not picked up by Lincoln as instructed until it received an invoice from Lincoln for the rental of forty-two cylinders. B.T. objected to the invoice and notified Lincoln that there were no cylinders in B.T.'s possession and that it had instructed Lincoln to pick up all of the cylinders it had delivered. However, Lincoln continuously invoiced B.T. for the rental of forty-two cylinders.

[¶6] Lincoln subsequently filed suit against B.T. alleging B.T. owed the sum of \$1,712.20 for the rental of forty-two cylinders for a 1½ year period. Lincoln also alleged in its petition that B.T. was responsible for the replacement of forty-two cylinders at a cost of \$6,767.04. Attached to Lincoln's petition was an affidavit from Ronald Wayne Shaffer, a representative of Lincoln, stating that he was familiar with Lincoln's books and records and that the records showed that forty-two cylinders delivered to B.T. had not been picked up by Lincoln. Despite the insistence by B.T. that Lincoln's records were in error, Lincoln maintained its records were accurate and the debt owed by B.T. for the rental and replacement of forty-two cylinders was correct.

[¶7] In preparation for trial it was discovered by Lincoln that B.T. had not been given credit for some cylinders which had been returned. At trial Lincoln introduced business records which allegedly indicated that only nineteen cylinders were unaccounted for instead of forty-two. The dollar amount sued for was reduced to \$2,975.93 for replacement of unreturned cylinders and \$916.01 for rental on unreturned cylinders.

[¶8] After trial on the merits, the trial judge in oral reasons held that there probably had been a loss by Lincoln due to unreturned cylinders but that he could not attribute any of the loss to B.T., and additionally the evidence was insufficient to establish the value or number of missing cylinders. Judgment was then signed dismissing Lincoln's suit. Lincoln claims on appeal that this was error. We affirm.

[¶9] Lincoln contends that the responsibility of B.T. for the missing cylinders was established from Lincoln's business records as testified to by Mr. Ronald Shaffer. Lincoln contends that its business records establish that B.T. owes rental and replacement costs on nineteen cylinders. Lincoln argues that B.T. has no records of the number of cylinders received or the number of cylinders returned to Lincoln and therefore under the terms of the contract is liable for the rental of the cylinders.

[¶10] The shipping orders (the contract between the parties) provided that: "(2) Customer shall and must return each cylinder and container, and all fittings and attachments thereto, when empty, safely at customer's cost and expense, to the distributing station of seller from which the same were shipped originally."

[¶11] The standard business practice in the fabrication industry, which was adhered to by Lincoln and B.T., is that the user notifies the seller of the amount of gas it needs and the place for the gas to be delivered. The seller then delivers the gas in the cylinders to the place designated by the user and at the same time picks up any empty cylinders. This establishes a course of dealing. La.R.S. 10:1-205(3).

[¶12] A course of dealing is allowed to give particular meaning to and supplement or qualify terms of an agreement. The course of dealing between Lincoln and B.T. qualifies the terms of the contract to allow the distributing station (place where cylinders are to be picked up) to be the place designated by the user (B.T.). Accordingly, we hold that B.T. has not breached any written obligation owed to Lincoln.

[¶13] There remains the issue of whether or not the business records introduced by Lincoln sufficiently establish responsibility for the allegedly missing cylinders. The trial judge was not convinced by Lincoln's business records that B.T. is responsible. We find no manifest error in this conclusion.

[¶14] Mr. Shaffer, credit manager for Lincoln, testified that the procedure for picking up cylinders for return is for the truck driver for Lincoln to go to the designated dock and pick up the empty cylinders. More than one Lincoln customer would use the same dock. At the dock, the truck driver requires someone to sign a cylinder receipt form. The form, however, does not signify which of Lincoln's customers using the same dock are credited for the returned cylinders. The only evidence of which returned cylinders should have been credited to a particular customer's account would be the testimony of the particular truck driver who serviced the dock used by B.T.

[¶15] As in any civil case, plaintiff has the burden of proving each and every essential element of its claim by a preponderance of the evidence. *Meyer v. State, Dept. of Public Safety License Control and Driver Improvement Div.*, 312 So.2d 289 (La.1975). The identity of the customer responsible for the missing cylinders is an essential element to Lincoln's claim. Absent the truck driver's testimony, we find that the trial court was not manifestly erroneous in finding that Lincoln had failed to establish by a preponderance of the evidence the responsibility of B.T. for the missing cylinders. *Canter v. Koehring Co.*, 283 So.2d 716 (La.1973). Therefore, Lincoln's first assignment of error is without merit.

[¶16] Lincoln argues the court erred when it refused to apply the account rendered rule that failure to object within a reasonable time to an account rendered is regarded as an admission of its correctness by the party charged.

[¶17] William G. Thomas, Sr., president of B.T., testified that after he received the invoices from Lincoln showing B.T. still possessed forty-two cylinders, he called Lincoln on several occasions informing Lincoln that all cylinders had been returned. Although the trial judge acknowledged that there were no letters of protest written by Thomas to

document the denial of this account, he found that B.T. did in fact object to the invoices. We find no manifest error.

[¶18] For the foregoing reasons, we affirm the judgment of the trial court. The trial judge assessed costs equally between the parties. Since neither party assigned as error the assessment of costs, we affirm the costs incurred at the trial level. However, we assess all appeal costs to the appellant.

Affirmed.

Questions:

1. Courts sometimes say that evidence of course of dealing may not contradict the written contract:

However, when considering a sale of goods contract under the U.C.C., the determination of a contract's meaning is not made in a vacuum. Rather, it is done *in conjunction* with evidence about course of dealing, usage of trade, and the parties' course of performance so long as that extrinsic evidence does not contradict the contract's language.

Lion Oil Trading & Transp., Inc. v. Statoil Marketing and Trading (US) Inc., 728 F. Supp. 2d 531, 535 (S.D.N.Y. 2010). Did the ruling in *Lincoln Big Three* violate this rule? Did it comply with the statute? What does "qualify" mean? Does it allow a trade usage, course of dealing, or course of performance to contradict a written term? One court cited a commentator for the following statement:

Astonishing as it will seem to most practicing attorneys, under the Code it will be possible in some cases to use custom to contradict the written agreement

Therefore usage may be used to "qualify" the agreement, which presumably means to "cut down" express terms although not to negate them entirely.

Nanakuli Paving and Rock Co. v. Shell Oil Co., Inc., 664 F.2d 772, 805 (9th Cir. 1981), quoting Joseph H. Levie, *Trade Usage and Custom Under the Common Law and the Uniform Commercial Code*, 40 N.Y.U. L. Rev. 1101, 1112 (1965). What in the code counters the word "qualify"? Where is the line? Did this case cross it? Can you square this result with § 1-303(e)(1)?

2. Was the re-delivery term ambiguous? Did it have to be?

3. Did the parties' course of dealing modify their written agreement? Could Lincoln have later stopping picking up cylinders and insisted instead that B.T. re-deliver cylinders that it leased?

4. A waiver is often defined as the intentional relinquishment of a known right. Did Lincoln waive the right to have BT responsibly re-deliver cylinders?

FRIGALIMENT IMPORTING CO., Ltd. v. B.N.S. INTERNATIONAL SALES CORP.
S.D. N.Y. (1960), 190 F. Supp. 116

FRIENDLY, Circuit Judge.

[¶1] The issue is, what is chicken? Plaintiff says "chicken" means a young chicken, suitable for broiling and frying. Defendant says "chicken" means any bird of that genus that meets contract specifications on weight and quality, including what it calls "stewing chicken" and plaintiff pejoratively terms "fowl". Dictionaries give both meanings, as well as some others not relevant here. To support its, plaintiff sends a number of volleys over the net; defendant essays to return them and adds a few serves of its own. Assuming that both parties were acting in good faith, the case nicely illustrates Holmes' remark "that the making of a contract depends not on the agreement of two minds in one intention, but on the agreement of two sets of external signs—not on the parties' having *meant* the same thing but on their having *said* the same thing." The Path of the Law, in Collected Legal Papers, p. 178. I have concluded that plaintiff has not sustained its burden of persuasion that the contract used "chicken" in the narrower sense.

[¶2] The action is for breach of the warranty that goods sold shall correspond to the description, New York Personal Property Law, McKinney's Consol. Laws, c. 41, § 95. Two contracts are in suit. In the first, dated May 2, 1957, defendant, a New York sales corporation, confirmed the sale to plaintiff, a Swiss corporation, of

"US Fresh Frozen Chicken, Grade A, Government Inspected, Eviscerated
2½-3 lbs. and 1½-2 lbs. each
all chicken individually wrapped in cryovac, packed in secured fiber cartons or
wooden boxes, suitable for export
75,000 lbs. 2½-3 lbs. @\$33.00
25,000 lbs. 1½-2 lbs. @\$36.50
per 100 lbs. FAS New York
scheduled May 10, 1957 pursuant to instructions from Penson & Co., New York."

[¶3] The second contract, also dated May 2, 1957, was identical save that only 50,000 lbs. of the heavier "chicken" were called for, the price of the smaller birds was \$37 per 100 lbs., and shipment was scheduled for May 30. The initial shipment under the first contract was short but the balance was shipped on May 17. When the initial shipment arrived in Switzerland, plaintiff found, on May 28, that the 2½-3 lbs. birds were not young chicken suitable for broiling and frying but stewing chicken or "fowl"; indeed, many of the cartons and bags plainly so indicated. Protests ensued. Nevertheless, shipment under the second contract was made on May 29, the 2½-3 lbs. birds again being stewing chicken. Defendant stopped the transportation of these at Rotterdam.

[¶4] This action followed. Plaintiff says that, notwithstanding that its acceptance was in Switzerland, New York law controls under the principle of *Rubin v. Irving Trust Co.*, 1953, 305 N.Y. 288, 305, 113 N.E.2d 424 431; defendant does not dispute this, and relies on New York decisions. I shall follow the apparent agreement of the parties as to the applicable law.

[¶5] Since the word "chicken" standing alone is ambiguous, I turn first to see whether the contract itself offers any aid to its interpretation. Plaintiff says the 1½-2 lbs. birds necessarily had to be young chicken since the older birds do not come in that size, hence the 2½-3 lbs. birds must likewise be young. This is unpersuasive; a contract for "apples" of two different sizes could be filled with different kinds of apples even though only one species came in both sizes. Defendant notes that the contract called not simply for chicken but for "US Fresh Frozen Chicken, Grade A, Government Inspected." It says the contract thereby incorporated by reference the Department of Agriculture's regulations, which favor its interpretation; I shall return to this after reviewing plaintiff's other contentions.

[¶6] The first hinges on an exchange of cablegrams which preceded execution of the formal contracts. The negotiations leading up to the contracts were conducted in New York between defendant's secretary, Ernest R. Bauer, and a Mr. Stovicek, who was in New York for the Czechoslovak government at the World Trade Fair. A few days after meeting Bauer at the fair, Stovicek telephoned and inquired whether defendant would be interested in exporting poultry to Switzerland. Bauer then met with Stovicek, who showed him a cable from plaintiff dated April 26, 1957, announcing that they "are buyer" of 25,000 lbs. of chicken 2½-3 lbs. weight, Cryovac packed, grade A Government inspected, at a price up to 33¢ per pound, for shipment on May 10, to be confirmed by the following morning, and were interested in further offerings. After testing the market for price, Bauer accepted, and Stovicek sent a confirmation that evening. Plaintiff stresses that, although these and subsequent cables between plaintiff and defendant, which laid the basis for the additional quantities under the first and for all of the second contract, were predominantly in German, they used the English word "chicken"; it claims this was done because it understood "chicken" meant young chicken whereas the German word, "Huhn," included both "Brathuhn" (broilers) and "Suppenhuhn" (stewing chicken), and that defendant, whose officers were thoroughly conversant with German, should have realized this. Whatever force this argument might otherwise have is largely drained away by Bauer's testimony that he asked Stovicek what kind of chickens were wanted, received the answer "any kind of chickens," and then, in German, asked whether the cable meant "Huhn" and received an affirmative response. Plaintiff attacks this as contrary to what Bauer testified on his deposition in March, 1959, and also on the ground that Stovicek had no authority to interpret the meaning of the cable. The first contention would be persuasive if sustained by the record, since Bauer was free at the trial from the threat of contradiction by Stovicek as he was not at the time of the deposition; however, review of the deposition does not convince me of the claimed inconsistency. As to the second contention, it may well be that Stovicek lacked authority to commit plaintiff for prices or delivery dates other than those specified in the cable; but plaintiff cannot at the same time rely on its cable to Stovicek as

its dictionary to the meaning of the contract and repudiate the interpretation given the dictionary by the man in whose hands it was put. See Restatement of the Law of Agency, 2d, § 145; 2 Mecham, Agency § 1781 (2d ed. 1914); *Park v. Moorman Mfg. Co.*, 1952, 121 Utah 339, 241 P.2d 914 919 40 A.L.R.2d 273; *Henderson v. Jimmerson*, Tex.Civ.App.1950, 234 S.W. 2d 710 717-718. Plaintiff's reliance on the fact that the contract forms contain the words "through the intermediary of: ", with the blank not filled, as negating agency, is wholly unpersuasive; the purpose of this clause was to permit filling in the name of an intermediary to whom a commission would be payable, not to blot out what had been the fact.

[¶7] Plaintiff's next contention is that there was a definite trade usage that "chicken" meant "young chicken." Defendant showed that it was only beginning in the poultry trade in 1957, thereby bringing itself within the principle that "when one of the parties is not a member of the trade or other circle, his acceptance of the standard must be made to appear" by proving either that he had actual knowledge of the usage or that the usage is "so generally known in the community that his actual individual knowledge of it may be inferred." 9 Wigmore, Evidence (3d ed. 1940) § 2464. Here there was no proof of actual knowledge of the alleged usage; indeed, it is quite plain that defendant's belief was to the contrary. In order to meet the alternative requirement, the law of New York demands a showing that "the usage is of so long continuance, so well established, so notorious, so universal and so reasonable in itself, as that the presumption is violent that the parties contracted with reference to it, and made it a part of their agreement." *Walls v. Bailey*, 1872, 49 N.Y. 464, 472-473.

[¶8] Plaintiff endeavored to establish such a usage by the testimony of three witnesses and certain other evidence. Strasser, resident buyer in New York for a large chain of Swiss cooperatives, testified that "on chicken I would definitely understand a broiler." However, the force of this testimony was considerably weakened by the fact that in his own transactions the witness, a careful businessman, protected himself by using "broiler" when that was what he wanted and "fowl" when he wished older birds. Indeed, there are some indications, dating back to a remark of Lord Mansfield, *Edie v. East India Co.*, 2 Burr. 1216, 1222 (1761), that no credit should be given "witnesses to usage, who could not adduce instances in verification." 7 Wigmore, Evidence (3d ed. 1940), § 1954; see *McDonald v. Acker, Merrill & Condit Co.*, 2d Dept.1920, 192 App.Div. 123 126 182 N.Y.S. 607. While Wigmore thinks this goes too far, a witness' consistent failure to rely on the alleged usage deprives his opinion testimony of much of its effect. Niesielowski, an officer of one of the companies that had furnished the stewing chicken to defendant, testified that "chicken" meant "the male species of the poultry industry. That could be a broiler, a fryer or a roaster", but not a stewing chicken; however, he also testified that upon receiving defendant's inquiry for "chickens", he asked whether the desire was for "fowl or frying chickens" and, in fact, supplied fowl, although taking the precaution of asking defendant, a day or two after plaintiff's acceptance of the contracts in suit, to change its confirmation of its order from "chickens," as defendant had originally prepared it, to "stewing chickens." Dates, an employee of Urner-Barry Company, which publishes a daily

market report on the poultry trade, gave it as his view that the trade meaning of "chicken" was "broilers and fryers." In addition to this opinion testimony, plaintiff relied on the fact that the Urner-Barry service, the Journal of Commerce, and Weinberg Bros. & Co. of Chicago, a large supplier of poultry, published quotations in a manner which, in one way or another, distinguish between "chicken," comprising broilers, fryers and certain other categories, and "fowl," which, Bauer acknowledged, included stewing chickens. This material would be impressive if there were nothing to the contrary. However, there was, as will now be seen.

[¶9] Defendant's witness Weininger, who operates a chicken eviscerating plant in New Jersey, testified, "Chicken is everything except a goose, a duck, and a turkey. Everything is a chicken, but then you have to say, you have to specify which category you want or that you are talking about." Its witness Fox said that in the trade "chicken" would encompass all the various classifications. Sadina, who conducts a food inspection service, testified that he would consider any bird coming within the classes of "chicken" in the Department of Agriculture's regulations to be a chicken. The specifications approved by the General Services Administration include fowl as well as broilers and fryers under the classification "chickens." Statistics of the Institute of American Poultry Industries use the phrases "Young chickens" and "Mature chickens," under the general heading "Total chickens," and the Department of Agriculture's daily and weekly price reports avoid use of the word "chicken" without specification.

[¶10] Defendant advances several other points which it claims affirmatively support its construction. Primary among these is the regulation of the Department of Agriculture, 7 C.F.R. § 70.300-70.370, entitled, "Grading and Inspection of Poultry and Edible Products Thereof." and in particular § 70.301 which recited:

"*Chickens*. The following are the various classes of chickens:

- (a) Broiler or fryer . . .
- (b) Roaster . . .
- (c) Capon . . .
- (d) Stag . . .
- (e) Hen or stewing chicken or fowl . . .
- (f) Cock or old rooster . . .

[¶11] Defendant argues, as previously noted, that the contract incorporated these regulations by reference. Plaintiff answers that the contract provision related simply to grade and Government inspection and did not incorporate the Government definition of "chicken," and also that the definition in the Regulations is ignored in the trade. However, the latter contention was contradicted by Weininger and Sadina; and there is force in defendant's argument that the contract made the regulations a dictionary, particularly since the reference to Government grading was already in plaintiff's initial cable to Stovicek.

[¶12] Defendant makes a further argument based on the impossibility of its obtaining broilers and fryers at the 33¢ price offered by plaintiff for the 2½-3 lbs. birds. There is no

substantial dispute that, in late April, 1957, the price for 2½-3 lbs. broilers was between 35 and 37¢ per pound, and that when defendant entered into the contracts, it was well aware of this and intended to fill them by supplying fowl in these weights. It claims that plaintiff must likewise have known the market since plaintiff had reserved shipping space on April 23, three days before plaintiff's cable to Stovicek, or, at least, that Stovicek was chargeable with such knowledge. It is scarcely an answer to say, as plaintiff does in its brief, that the 33¢ price offered by the 2½-3 lbs. "chickens" was closer to the prevailing 35¢ price for broilers than to the 30¢ at which defendant procured fowl. Plaintiff must have expected defendant to make some profit; certainly it could not have expected defendant deliberately to incur a loss.

[¶13] Finally, defendant relies on conduct by the plaintiff after the first shipment had been received. On May 28 plaintiff sent two cables complaining that the larger birds in the first shipment constituted "fowl." Defendant answered with a cable refusing to recognize plaintiff's objection and announcing "We have today ready for shipment 50,000 lbs. chicken 2½-3 lbs. 25,000 lbs. broilers 1½-2 lbs.," these being the goods procured for shipment under the second contract, and asked immediate answer "whether we are to ship this merchandise to you and whether you will accept the merchandise." After several other cable exchanges, plaintiff replied on May 29 "Confirm again that merchandise is to be shipped since resold by us if not enough pursuant to contract chickens are shipped the missing quantity is to be shipped within ten days stop we resold to our customers pursuant to your contract chickens grade A you have to deliver us said merchandise we again state that we shall make you fully responsible for all resulting costs."* Defendant argues that if plaintiff was sincere in thinking it was entitled to young chickens, plaintiff would not have allowed the shipment under the second contract to go forward, since the distinction between broilers and chickens drawn in defendant's cablegram must have made it clear that the larger birds would not be broilers. However, plaintiff answers that the cables show plaintiff was insisting on delivery of young chickens and that defendant shipped old ones at its peril. Defendant's point would be highly relevant on another disputed issue: whether if liability were established, the measure of damages should be the difference in market value of broilers and stewing chicken in New York or the larger difference in Europe, but I cannot give it weight on the issue of interpretation. Defendant points out also that plaintiff proceeded to deliver some of the larger birds in Europe, describing them as "poulets"; defendant argues that it was only when plaintiff's customers complained about this that plaintiff developed the idea that "chicken" meant "young chicken." There is little force in this in view of plaintiff's immediate and consistent protests.

[¶14] When all the evidence is reviewed, it is clear that defendant believed it could comply with the contracts by delivering stewing chicken in the 2½-3 lbs. size. Defendant's subjective intent would not be significant if this did not coincide with an objective meaning of "chicken." Here it did coincide with one of the dictionary meanings, with the definition in the Department of Agriculture Regulations to which the contract made at least oblique

* These cables were in German; "chicken", "broilers" and, on some occasions, "fowl," were in English.

reference, with at least some usage in the trade, with the realities of the market, and with what plaintiff's spokesman had said. Plaintiff asserts it to be equally plain that plaintiff's own subjective intent was to obtain broilers and fryers; the only evidence against this is the material as to market prices and this may not have been sufficiently brought home. In any event it is unnecessary to determine that issue. For plaintiff has the burden of showing that "chicken" was used in the narrower rather than in the broader sense, and this it has not sustained.

This opinion constitutes the Court's findings of fact and conclusions of law. Judgment shall be entered dismissing the complaint with costs.

Questions:

1. Every year thousands of law students read the chicken case. What if anything do you learn from it? Will you be a better lawyer for having read it? How?
2. What did Holmes mean when he said that "the making of a contract depends not on the agreement of two minds in one intention, but on the agreement of two sets of external signs—not on the parties' having meant the same thing but on their having said the same thing"?
3. Why does Friendly say that this case "nicely illustrates" Holmes' remark?
4. Which model(s) of language meaning are consistent with Friendly's reasoning? In other words, which models of language meaning allow the law to resolve ambiguity using evidence?
5. Judge Friendly later wrote that this case might be about assent. He said that lack of assent was proved because of the misunderstanding between the parties. Is the chicken case like the case of the two ships *Peerless* (which you should have studied in the first semester of Contracts)? Can you resolve the chicken case on the basis of Restatement (Second) of Contracts § 20? Interestingly enough, the statement of Holmes that Friendly quoted was about the *Peerless* case. If Judge Friendly's later assertion is correct, then his earlier assumption that a contract existed in the case is wrong. And if there was no contract, the buyer would not have to pay the price of the chicken, only the chicken's value.

B. Writing the Promise: What Effect?

Some contracts have traditionally been written: promissory notes, which could be traded as cash; land sales; and marriage contracts in some cultures, for example. Some promises, such as those in sealed documents, could be enforced under the common law through a streamlined procedure called *debt sur obligation*. Defendants subject to an action of *debt sur obligation* had very few defenses. The writing determined almost everything

the court needed to know to impose a remedy. The push to capture bargains in writing was strengthened by the Statute of Frauds (1677), which required that certain important kinds of contract be written and also signed by the promisor.

Once parties decide to write a promise, the courts have to decide whether to give legal effect to the fact that the parties put the promise in writing, and what that effect will be. Neither is a foregone conclusion.

Why would one want to write a promise? Should the reason for writing a promise effect what importance a court decides to give to the writing?

1. Mistake in Transmission

GREAT-WEST INVESTORS LP v. THOMAS H. LEE PARTNERS, L.P. et al. Del. Ch. (2011)

[¶1] In the Chinese version of an old folk tale, the Emperor was so impressed with the game of chess that he offered its inventor a reward of his choice. The inventor said that he was a simple man, and wanted only a few grains of rice, the number of which would be determined by the chessboard itself. All he asked for was a single grain of rice for the first square on the board, double that amount for the second square, and that amount doubled again for each of the board's remaining sixty-two squares. The Emperor accepted the proposal immediately, pleased, and even a little insulted that the inventor had asked for so meager a reward. The inventor came to collect one square's worth of rice per day. It was only a few grains at first, but by the third week he was collecting enough rice to feed his family for a day. By the last day of the first month, however, he was due more rice than his entire village could eat in a year. As the sixty-fourth day approached, when the man would justly be able to demand many times more rice than existed in all of China or, indeed the world,* the Emperor realized he was ruined.

[¶2] In this case, the defendants (a limited partnership, its general partner, and its manager) argue that a similar deal, contemplating a fee that would more than double each year, exists between them and the plaintiff (one of the limited partners). The first square of this figurative chessboard, however, is filled not with a single grain of rice, but instead with nearly \$48 million.

[¶3] The plaintiff has brought claims for a declaration that the limited partnership agreement does not require it to pay a fee that more than doubles every year, specific

* The last square would contain 2⁶³, or 9,223,372,036,854,775,808 grains of rice. At more than 29,000 grains per pound (see <http://www.producersrice.com/rice/facts.html>), this figure represents nearly 213 times the amount of rice produced globally in 2009. See Food and Agric. Org. of the U.N., Rice Market Monitor, December 2009, http://www.fao.org/es/ESC/en/15/70/highlight_71.html.

performance of the agreement as it interprets it, breach of contract, breach of fiduciary duty, and breach of the implied covenant of good faith and fair dealing. In the alternative, the plaintiff seeks reformation of the agreement for mistake or fraud. This memorandum opinion addresses the defendants' motion to dismiss the Complaint.

II. BACKGROUND*

[¶4] Thomas H. Lee Partners, L.P. [the "Partnership"] is a Delaware limited partnership that promotes and manages private-equity buyout funds. A limited partnership is a partnership with both (i) a general partner(s) who has the right to manage and (ii) limited partners who are merely investors in the limited partnership. It is governed by a limited partnership agreement [here called the "LP Agreement"]. Thomas H. Lee Advisors, LLC ["TH Lee"] is the general partner of the Partnership. Thomas H. Lee Management Company, LLC [the "Manager"] is the manager, by contract with the general partner, of the Partnership.

[¶5] Great-West Investors LP ["Great-West"] is one of the limited partners in the Partnership. Great-West is the Special Limited Partner ["SLP"], which means that it has rights and duties different from the other limited partners. Great-West became the SLP when it bought Putnam Investments, Inc., on August 3, 2007. Putnam had been the SLP.

[¶6] A private equity buy-out occurs when a person or small group of persons buys all or most of the stock or other equity interest of a company. These interests entitle the persons to distributions of company profits and also subject their investment to company losses. As part of its work, the Partnership gathers groups of investors who contribute to a "fund" (best thought of as a separate entity as well as an aggregation of money); the Partnership then uses the fund to negotiate and pay for an equity buy-out(s). The funds pay the Partnership for this service, and limited partners of the Partnership receive income from the Partnership based on this activity, called Partnership Fee Income. Limited partners can also be investors in the funds, and they would receive income individually from these.

[¶7] The Manager, who is not a Partner but manages the business of the Partnership, is separately compensated. Specifically, the partners pay the Manager. Under the LP Agreement, certain limited partners, including the SLP, were required to pay to the Partnership "Expense Assumption" payments on Apr. 21 and Oct. 21 of each year from 1999 to 2009. The Partnership would pay these sums to the Manager. The LP Agreement gave a formula for determining the amount due. In 2009, the Expense Assumption was \$47,703,343. It went up by 5% each year from 2000 to 2009, by agreement.

[¶8] The payments due after 2009 were not specified in the same way under the agreement. Instead, after 2009, the general partner and the SLP were to negotiate in good faith about the Expense Assumption and Fee Income. The negotiated agreement had a

* Facts here given by the casebook author.

stated purpose: that the SLP was to have 25% of Fee Income and pay 25% of expenses. But the paragraph specifying this had a tag line:

In the event that the General Partner and the Special Limited Partner are unable to agree on such allocation, the Expense Assumption then in effect will increase on January 1 or each year, commencing January 1, 2010, by an amount equal to the product of 1.05 multiplied by the Expense Assumption in effect during the preceding year.*

[¶9] That language presented a problem. Before it bought Putnam, Great-West worried about this clause. Putnam and its counsel told Great-West that the default amount by which the Expense Assumption would increase would be 5%. Great-West then asked that the provision be modified to say that clearly. On July 19, 2007, Putnam’s counsel and the Partnership’s outside counsel acknowledged that the provision “was intended ‘to effect a 5% increase and agreed to clarify the provision to make such intent more explicit.’” The Partnership’s counsel afterward told Putnam’s counsel that such a clarification was reasonable but then said that the Partnership was not interested in changing anything at this time. He said that clearly Great-West and the Partnership would need to have a negotiation, but he refused to do it then. Never did the Partnership’s counsel or the Partnership suggest that the Expense Assumption would go up any more than 5% annually if the default rate was triggered.

[¶10] Great-West bought Putnam on August 3, 2007, and later executed a Fourth LP Agreement that repeated the same provision quoted above, even though some other language in that paragraph changed.

[¶11] Later, in the years following 2009, Great-West tried to negotiate, but the Partnership instead suggested Great-West sell its interest. The Partnership proposed scenarios in which Great-West would have to divest its stake on unreasonable terms. Moreover, the Partnership then claimed that the default escalation was not 5% but 105%. No agreement was reached. The next year, the Partnership claimed the Expense Assumption went up by 105% and charged Great-West \$97,791,853. Great-West estimates that the actual expenses would be covered if nothing changed from 2009. It estimates that actual expenses are about \$45 million. If Great-West paid what it paid in 2009, even that would yield the managers a \$2.3 million profit.

[¶12] Interestingly, the LP Agreement provided that any amounts paid to it to cover expenses would first be used to cover expenses but that the excess would be distributed to owners of the Manager. Some of these owners of the Manager are also limited partners of the Partnership. Great-West has no interest in the Manager, however.

[¶13] Incidentally, a 105% increase would make the Expense Assumption for 2019 \$62.5 billion. Great-West estimates that it would exceed the total income of the partnership by

* Does the clause require $EA \times 1.05 = \text{Next Year's EA}$, or $EA + (EA \cdot 1.05) = \text{Next Year's EA}$?

2013. Such a payment obligation would wipe out Great-West's interest in the Partnership Fee income almost immediately.]

III. CONTENTIONS

[¶14] By Count I of the Complaint, Great-West seeks declaratory relief. Subpart (a) seeks a declaration that TH Lee may increase the Expense Assumption from the amount in effect for 2009 only after it engages with Great-West in good faith negotiations as required by § 12.2(c). Subpart (b) of Count I seeks a declaration that § 12.2(c) of the LP Agreement allows only a 5% annual increase in the Expense Assumption in the event such negotiations fail to reach an agreement. Defendants argue that § 12.2(c) unambiguously provides that the Expense Assumption will grow by 105% annually in the absence of an agreement to allocate expenses differently. Great-West responds that the language of § 12.2(c) is at least ambiguous, and that extrinsic evidence supports its position that the provision provides for only a 5% annual increase. * * * *

[¶15] Counts IV and V seek reformation of the LP Agreement for mutual mistake and unilateral mistake, respectively. Defendants argue that Great-West has failed to state a claim for mistake because it has not identified a specific prior agreement between the parties that is not reflected in the written contract. Further, Defendants argue that Great-West waived any claim for mistake based on conduct that occurred before it became the Special Limited Partner by executing the Fourth LP Agreement a year after it had acquired Putnam's interest in the Partnership. Great-West asserts that the parties reached an agreement on the size of the default escalator in the Expense Assumption, and that whether the underlying mistake was unilateral or mutual, Great-West did not waive its claim by executing the Fourth LP Agreement because there was no reason it should have known of the mistake when it signed that agreement in 2008.

[¶16] Count VI seeks reformation for fraud. Defendants contend that this claim essentially duplicates Great-West's claim for reformation for unilateral mistake and should be dismissed for the same reasons. Great-West responds that it can show that the Defendants intentionally misled it and that its allegations thus support a claim for fraud. * * * *

IV. DISCUSSION

* * * * 2. Subpart (b): the amount of the default escalator of the Expense Assumption

[¶17] Under § 12.2(c), if good faith negotiations fail to result in an agreement regarding the allocation of Fee Income and expenses, the Special Limited Partner must pay an annual Expense Assumption that escalates according to the following formula: "the Expense Assumption then in effect will increase on January 1 of each year, commencing on January 1, 2010, by an amount equal to the product of 1.05 multiplied by the Expense Assumption in effect during the preceding year."

[¶18] The meaning of this sentence is plain: if the Expense Assumption escalator was triggered by failure to reach an agreement in 2009, then the Expense Assumption that was in effect for 2009 would increase by 105% of the 2009 Expense Assumption amount. That is, the Expense Assumption would grow from \$47,703,343 in 2009 to $\$47,703,343 + (1.05 * \$47,703,343)$, or \$97,791,853.15, for 2010. Defendants contend that this is the only reasonable interpretation of the sentence, and that Great-West's claim that it means something else should be rejected.

[¶19] Great-West argues, however, that Defendants' reading misconstrues the meaning of the word "by," which it says has the definition given to it by the American Heritage Dictionary: "to the extent or amount of." Great-West argues that using this definition leads to conclusion that § 12.2 unambiguously provides for a default 5% annual escalator: that the Expense Assumption should have increased on January 1, 2010 to the extent that the 2010 Expense Assumption would equal 105% of the 2009 Expense Assumption. Defendants contend that, even if the Court were to use Great-West's definition of "by," a fair reading of § 12.2 supports Defendants' position.

[¶20] Although the Court understands Great-West's desire to find an interpretation of § 12.2 that would not require the Expense Assumption to more than double annually in the event it cannot negotiate a different allocation agreement with TH Lee, the reading Great-West advances is not supported by the text. The illustration incorporated into the American Heritage Dictionary's definition of "by," is "He's taller than his sister by three inches." Using that definition in place of "by" yields: "He's taller than his sister to the extent or amount of three inches." Paraphrasing that sentence to build a sentence that uses "by" in the same way Great-West argues it is used in § 12.2(c), however, yields a nonsensical result. "Her brother's height increased by three inches," for example, cannot be read to mean "Her brother's height increased to the extent or amount of three inches, and he is now three inches tall."

[¶21] Likewise, § 12.2 provides that, in the absence of an agreement otherwise, the Expense Assumption will "increase by" 105% of the previous year's Expense Assumption; that sentence cannot plausibly be read to mean the Expense Assumption will increase such that the 2010 amount is only 105% of the 2009 amount. The words following "increased by" must indicate the amount that will be added to the 2009 Expense Assumption to reach the 2010 amount in the event good faith negotiations do not produce an alternate agreement.

[¶22] Great-West also attempts to encourage a conclusion that the language of the default Expense Assumption escalator is ambiguous by insisting that the Defendants' interpretation produces an unconscionable and absurd result.* That Great-West does not

* Despite making a passing reference to an "unconscionable 105%" annual increase in the Expense Assumption (Compl. ¶ 2), Great-West has not squarely alleged that it can avoid the contract as written

like the result, however, does not render it ambiguous if the result is required by the plain language of the contract. As the Court has observed, “parties are free to make bad bargains.” The Court’s role is not “to rewrite the contract between sophisticated market participants, allocating the risk of an agreement after the fact, to suit the court’s sense of equity or fairness.” Instead, “[i]t is to give meaning and substance to the words the parties have freely chosen.”

[¶23] Although Great-West may wish it had not agreed to the possibility of annual 105% increases in the Expense Assumption, the only reasonable interpretation of the sentence in question is that it in fact did so in 2007 and again in 2008. Accordingly, the Court grants Defendants’ motion to dismiss subpart (b) of Count I. The Court denies the motion to dismiss subpart (a) of Count I, which seeks a declaration that “the Expense Assumption may increase from the amount in effect for 2009 only after TH Lee has negotiated in good faith with Great-West Investors concerning the allocation of Fee Income and related expenses premised on Great-West Investors receiving 25% of Fee Income.”

E. Count IV-VI: Reformation for Mistake or Fraud

[¶24] Great-West next contends that, if § 12.2(c) effects a 105% annual increase in the Expense Assumption in the event the parties cannot reach a new agreement regarding the allocation of Fee Income and expenses, then the Court should reform § 12.2(c) such that it, instead, allows only a 5% annual increase in the Expense Assumption under those circumstances. The Court may reform a contract “only when the contract does not represent the parties’ intent because of fraud, mutual mistake or, in exceptional cases, a unilateral mistake coupled with the other parties’ knowing silence.” Great-West presents three possible justifications for reforming the LP Agreement: mutual mistake (Count IV), unilateral mistake (Count V), and fraud (Count VI).

[¶25] A claim for reformation based on a mutual mistake will survive a motion to dismiss under Court of Chancery Rule 12(b)(6) only if it alleges: (i) that the parties reached a definite agreement before executing the final contract; (ii) that the final contract failed to incorporate the terms of the agreement; (iii) that the parties’ mutually mistaken belief reflected the true parties’ true agreement; and (iv) the precise mistake the parties made.

because it is unconscionable—perhaps because it might be difficult to prevail under that theory. A contract is unconscionable only if it is characterized by both “an absence of meaningful choice and contract terms unreasonably favorable to one of the parties.” *Tulowitzki v. Atl. Richfield Co.*, 396 A.2d 956, 960 (Del. 1978). Great-West and the Defendants are all sophisticated parties. Great-West was concerned about the language of §12.2(c) before it acquired Putnam and, had it been sufficiently alarmed, could have chosen to walk away from its purchase of Putnam. See *Progressive Int’l Corp. v. E.I. Du Pont de Nemours & Co.*, 2002 WL 1558382, at *8 (Del. Ch. July 9, 2002) (holding that strict, unilaterally-imposed confidentiality requirements that hampered Progressive’s due diligence efforts did not deprive Progressive of a meaningful choice because it always retained the ability to walk away from the transaction).

[¶26] Great-West alleges that on July 19, 2007, Putnam’s counsel, Mr. D’Oench, informed Mr. Kreisler of Putnam’s and Great-West’s belief that § 12.2(c) provided for a 5% annual increase. It further alleges that Mr. Kreisler agreed that § 12.2(c) had the meaning Great-West and Putnam ascribed to it as written, but that the wording should be modified to convey that meaning expressly. Great-West contends that Defendants were aware that Mr. Kreisler’s words would be conveyed to Great-West through Putnam. Finally, Great-West contends that, while Mr. Kreisler’s July 26, 2007 email to Mr. D’Oench did explain that the Partnership was not interested in making changes to the language of § 12.2(c), it did not actually retract Mr. Kreisler’s representation that § 12.2(c), as written, had the meaning Mr. D’Oench had ascribed to it. Great-West became the Special Limited Partner by acquiring Putnam soon after these communications.

[¶27] Read in the light most favorable to it, Great-West’s allegations could support an inference that Mr. Kreisler never retracted the July 2007 representation that § 12.2(c) had the meaning Putnam’s counsel had ascribed to it, and that he did not do so because the mistaken interpretation of Great-West and Putnam was consistent with Defendants’ own interpretation of the provision at that time. Under these allegations, Great-West could conceivably prove that the parties had a definite agreement regarding the meaning of § 12.2(c), and had no reason to question that interpretation when they executed the Amended LP Agreement in August 2008. Nonetheless, the language of § 12.2(c) did not reflect that alleged agreement. As a result, Great-West has adequately alleged a mutual mistake claim.

[¶28] In the alternative, Great-West presents a claim for reformation of the LP Agreement on the basis of unilateral mistake. To prove unilateral mistake “[t]he party asserting this doctrine must show that it was mistaken and that the other party knew of the mistake but remained silent.” The plaintiff must also show that the parties had come to a definite agreement that differed materially from the written agreement. Great-West alleges that, if Defendants believed all along that § 12.2(c) provided for a 105% annual escalation of the Expense Assumption, the communications between Mr. D’Oench and Mr. Kreisler indicate both knowledge of Great-West’s mistake and silence as to that mistake. Great-West’s allegations could support an inference to that effect, and its allegations regarding mutual mistake satisfy the other elements of a unilateral mistake claim.

[¶29] Great-West executed the Fourth LP Agreement on August 1, 2008. By that act, according to Defendants, Great-West waived any claim for mistake. As compared to the Third LP Agreement, the Fourth LP Agreement amended some of the language in § 12.2(c), but left unchanged the language concerning the default annual escalation of the Expense Assumption amount. Proof that, as of that date, Great-West knew that the escalation language provided for a 105% annual increase in the Expense Assumption might indicate that Great-West had waived its claims that the LP Agreement should be reformed based on a 2007 mistaken interpretation of that language. Great-West alleges, however, that its interpretation of the language had not changed between 2007 and 2008 and that there was no reason for it to have known of its mistake when it executed the 2008 Amended LP Agreement. Because the pleadings do not identify any additional communications between

the parties between July 2007 and August 2008, the Court must accept, for purposes of the pending motion to dismiss, that Great-West had no reason to know of its mistake in August 2008 and did not waive its mistake claims by executing the Amended LP Agreement at that time.

[¶30] Thus, the Court denies Defendants' motion to dismiss Counts IV and V, which seek reformation of the LP Agreement for mutual mistake and unilateral mistake, respectively.

[¶31] Finally, under Count VI, Great-West seeks, on the basis of fraud, reformation of § 12.2(c) to establish a default annual escalator of 5%. To state a claim for fraud, a plaintiff must allege (i) a misrepresentation, which can take the form of a statement, omission, or active concealment of the truth; (ii) the defendant's knowledge that the representation was false; (iii) intent to induce the plaintiff to act or refrain from acting; (iv) justified reliance on the misrepresentation; and (v) damage as a result of such reliance.

[¶32] The Defendants have not sought dismissal of Count VI under Court of Chancery Rule 9(b), which requires that fraud be pled with particularity. GreatWest has identified three alleged misrepresentations relating to this subject matter with the particularity necessary to support a fraud claim. Great-West alleges that in a July 19, 2007 telephone conversation between Mr. Kreisler and Mr. D'Oench, Mr. D'Oench represented (i) that he agreed that the intent of §12.2(c) was to establish a 5% annual increase in the Expense Assumption as the default in absence of other agreement and (ii) that his client would clarify the language to make that meaning clear. Great-West alleges that, in a July 26 email to Mr. D'Oench, Mr. Kreisler retracted his previous representation that the language of § 12.2(c) would be clarified at that time, but represented (iii) that TH Lee would have to negotiate with Great-West regarding the provisions pertaining to the Expense Assumption at a future date. According to Great-West, Defendants made these representations knowingly and with the intent to induce Great-West to become the Special Limited Partner and to enter the LP Agreement, and GreatWest made its decisions to do so in reasonable reliance upon the alleged misrepresentations.

[¶33] Taken together, the representations identified by Great-West would reasonably have left it with the impression that Defendants agreed with it that § 12.2(c) was intended to effect a default annual 5% escalator in the Expense Assumption and that Defendants would negotiate to implement that intention after Great-West became the Special Limited Partner. At face value, these allegations could support a claim for reformation based on fraud.

[¶34] Upon closer examination, however, the requirement of justifiable reliance on the alleged misrepresentations presents a significant challenge to the survival of this claim. First, Great-West's own arguments demonstrate the difficulty in establishing this element. During the October 18, 2010 hearing before the Court, Great-West seemed to take the position that whatever was said before it acquired Putnam regarding the meaning of §

12.2(c) did not affect its decision to become the Special Limited Partner or to enter the LP Agreement:

To some extent none of this matters. Why? Well, we became a special limited partner by operation of law. We weren't negotiating with TH Lee about this provision. We—we were about to own this thing. We would have owned it regardless. We—we had just bought Putnam. It was going to be ours. So whatever this meant, whatever they might have said in 2007, we'd probably still be here today even if we'd said “Well, we're not going to sign this amendment.” So what? We're still going to be the special limited partner because we stepped into Putnam's shoes. The Court is hesitant to dismiss an otherwise well-pled, even if only marginally so, fraud claim based on its counsel's argument, especially because in the context of a motion to dismiss the Court must generally consider only the allegations of the Complaint. Here, the Complaint does allege that Great-West justifiably relied on the alleged misrepresentations identified above. Nonetheless, the argument quoted here does illustrate the challenge Great-West may encounter in proving justifiable reliance going forward.

[¶35] Assuming it can overcome this difficulty, Great-West might also be able to establish the other elements of its claim for reformation on the basis of fraud. Although scienter would seem difficult to establish on the basis of the specific facts set forth in the Complaint, Great-West has alleged that Defendants acted intentionally. Further, Great-West could conceivably show that, because of the alleged misrepresentations, the LP Agreement does not reflect the parties' real agreement that § 12.2(c) would, after negotiations that were to occur after GreatWest acquired Putnam, impose by default a 5% annual escalator in the Expense Assumption.

[¶36] Considering Great-West's allegations in the plaintiff-friendly light illuminating them on a motion to dismiss, they adequately state a claim for reformation on the basis of fraud, if only barely. Accordingly, the Court denies Defendants' motion to dismiss Count VI.

Questions:

1. Does complexity equal ambiguity?
2. Does Great-West's understanding of the meaning of the clause at issue render it ambiguous?
3. Does the mistake in transmission doctrine threaten to overwhelm the plain meaning rule? Why or why not?
4. How satisfied are you that Thomas H. Lee Partners agreed to the interpretation of the clause argued by Great-West? Do you believe the court reached the wrong result? Incidentally, Thomas H. Lee Partners' website states, “We have built our culture upon a foundation of teamwork, open communication, and intellectual honesty. We require the

highest level of personal integrity and always treat others with respect. We conduct business in a straightforward and transparent manner, working with colleagues, investors and management teams as true partners.”

2. Parol Evidence

Now we reach the parol evidence rule—the rule you were cautioned about after *Tips*. Please remember the issue that the parol evidence rule addresses: whether any words should be added to or taken from the parties’ written contract, when they have a written contract. The parol evidence rule is not about the meaning of words, whether in the contract or out of it. It is about which words or terms are included in the contract.

Please keep in mind what was said before: Courts sometimes mention the plain meaning rule in the same passage as the parol evidence rule, and you will have to use context to determine what they are doing. If they are ruling on ambiguity in the words, that is about meaning. If they are ruling on whether some term not in the written agreement belongs in it or otherwise modifies the writing, that is parol evidence rule territory.

COLLIERS, DOW AND CONDON, INC. v. Leonard J. SCHWARTZ et al.
Conn. App. (2003), 823 A.2d 438

Opinion

[¶1] WEST, J. The plaintiff, Colliers, Dow and Condon, Inc., appeals from the judgment of the trial court rendered in favor of the defendants in this breach of contract action. The plaintiff claims that the court improperly (1) relied on parol evidence to vary an express term of a real estate brokerage agreement * * * .^{*} We agree with the plaintiff and reverse the judgment of the trial court.

[¶2] The following facts are relevant to our disposition of the plaintiff’s appeal. The controversy between the parties arises from the leasing of certain commercial property at 631-635-637 Farmington Avenue in West Hartford and owned by the defendant K.F.

^{*} As framed by the plaintiff, the parol evidence claim challenges: (1) the court’s conclusion that the parties’ contract did not allow the plaintiff to recover a commission in the event that the subject property was leased, and (2) the court’s finding that there was no understanding between the parties that the plaintiff would be entitled to a commission for leasing the premises. Because we conclude that the court’s reliance on parol evidence was improper, we need not reach the issue of whether the finding derived from that evidence, that there was no meeting of the minds between the parties as to leasing of the subject property, was clearly erroneous.

Associates, LLP. The defendant Leonard J. Schwartz is a managing partner in K.F. Associates, LLP.*

[¶3] The parties have conducted business with each other on several prior occasions. The plaintiff leased, and subsequently sold, one of Schwartz's buildings located in Bloomfield. The plaintiff later sold a small office building in West Hartford for Schwartz. In 1994, the defendants engaged the plaintiff's services to lease 1450 square feet of the subject property.† Following the success of those endeavors, the parties, in 1995, signed an agreement captioned "Exclusive Right To Sell/ Exchange Agreement," under which the plaintiff was to secure a buyer for the subject premises.

[¶4] In 1997, the parties signed an agreement captioned "Exclusive Right to Sell/Exchange/Lease Agreement," which is the subject of this appeal. At that time, a company named Imagineers was occupying approximately 86 percent of the subject property as a tenant. Schwartz asked John Tully, a licensed brokerage representative of the plaintiff, to approach Imagineers about buying the property. Tully's discussions with Imagineers culminated in a letter in which he presented two proposed acquisition plans for the property. Imagineers responded with a counteroffer at a price well below either of the plaintiff's proposals. As an alternative, Imagineers proposed to Schwartz directly that it continue to rent the building under a five year lease, with an option to renew for another five years, at \$120,000 a year for the first five years and \$130,000 a year for the second five year period. Under that arrangement, Imagineers would make certain improvements to the property, and provide landscaping and snow removal. A final counteroffer proposed an initial five year lease at \$135,000 with an option for an additional five year lease at \$145,000, with the defendants making necessary repairs.

[¶5] Between March 3 and August 26, 1998, a series of letters were exchanged between Imagineers and Schwartz. On August 26, 1998, Schwartz and Imagineers signed a lease agreement, effective February 1, 1999. On April 19, 1999, the plaintiff sent the defendants a bill for real estate brokerage services rendered pursuant to their exclusive listing agreement. The amount requested was 5 percent of the anticipated rent to be paid during the first five year lease period, or \$42,750.80. Schwartz refused to make payment, and this action followed.

I

[¶6] The plaintiff's first claim is that the court improperly relied on parol evidence to contradict an express term of the parties' contract. We agree.

* K.F. Associates, LLP, a limited liability partnership formed on October 22, 1996, is the successor in interest to K.F. Associates, a general partnership formed on January 25, 1983. Schwartz also was the managing partner of the general partnership. Any references to K.F. Associates regarding transactions that occurred prior to October 22, 1996, are to the general partnership, rather than to the limited liability partnership.

† That brokerage service was provided pursuant to a contract captioned "Exclusive Right To Lease Agreement."

[¶7] At the outset, we set forth the applicable standard of review. Ordinarily, “[o]n appeal, the trial court’s rulings on the admissibility of evidence are accorded great deference. . . . Rulings on such matters will be disturbed only upon a showing of clear abuse of discretion. . . . Because the parol evidence rule is not an exclusionary rule of evidence, however, but a rule of substantive contract law . . . the defendants’ claim involves a question of law to which we afford plenary review.” (Citations omitted; internal quotation marks omitted.) *Harold Cohn & Co. v. Harco International, LLC*, 72 Conn. App. 43, 48, 804 A.2d 218, cert. denied, 262 Conn. 903, 810 A.2d 269 (2002).

[¶8] The parol evidence rule is “premised upon the idea that when the parties have deliberately put their engagements into writing, in such terms as import a legal obligation, without any uncertainty as to the object or extent of such engagement, it is conclusively presumed, that the whole engagement of the parties, and the extent and manner of their understanding, was reduced to writing. After this, to permit oral testimony, or prior or contemporaneous conversations, or usages [etc.], in order to learn what was intended, or to contradict what is written, would be dangerous and unjust in the extreme. . . .

[¶9] “The parol evidence rule does not of itself, therefore, forbid the presentation of parol evidence, that is, evidence outside the four corners of the contract concerning matters covered by an integrated contract, but forbids only the use of such evidence to vary or contradict the terms of such a contract. Parol evidence offered solely to vary or contradict the written terms of an integrated contract is, therefore, legally irrelevant. When offered for that purpose, it is inadmissible not because it is parol evidence, but because it is irrelevant. By implication, such evidence may still be admissible if relevant . . . to show mistake or fraud. . . . [This] recognized [exception is], of course, only [an example] of [a situation] where the evidence . . . tends to show that the contract should be defeated or altered on the equitable ground that relief can be had against any deed or contract in writing founded in mistake or fraud.” (Citations omitted; internal quotation marks omitted.) *Heyman Associates No. 1 v. Ins. Co. of Pennsylvania*, 231 Conn. 756, 780–81, 653 A.2d 122 (1995).

[¶10] As an initial matter, we must frame the issue before this court. The plaintiff contends that the trial court relied on parol evidence to vary an express term of a contract, specifically, to read the word “lease” out of an otherwise valid contract. The defendants argue that the court relied on the parol evidence to make a preliminary finding that because there was no meeting of the minds between the parties as to the leasing of the subject property, there was no contract at all. We agree with the plaintiff.

[¶11] Because the defendants conceded in their answer to the complaint that Schwartz had entered into a contract with the plaintiff for professional real estate brokerage services, the validity of the contract was not before the court; only the scope of that contract was at issue. Moreover, the court’s memorandum of decision does not state that there was no agreement. The court found only that there was no agreement as to leasing, implicitly leaving intact that portion of the agreement relating to efforts to sell the property. The legal

consequence of the court's finding, therefore, was to strike that portion of the contract relating to leasing. We analyze the claims raised in this appeal in that light.

[¶12] The defendants contend that the renewal of the parties' agreement was solely for the purpose of securing a buyer for the property and was not intended to include any efforts to lease the premises. Schwartz testified in support of that proposition. He stated that upon receiving the agreement, he called Tully and asked if the agreement meant that he was going to sell the building, if, in effect, the agreement was essentially the same as the earlier "right to sell/exchange" agreement. According to Schwartz, Tully responded, "Yes, it's only for selling the building." On the basis of that parol evidence, the court found that there was no meeting of the minds that the plaintiff would be entitled to a commission for leasing the premises. Specifically, the court found that in entering into the agreement, the defendants had not intended to retain the services of the plaintiff to lease the subject property, but had intended to retain the plaintiff's services solely for the purpose of selling that property.*

[¶13] That finding, however, directly contradicts the express terms of the contract. The parties' written agreement provides that a commission is to be paid to the plaintiff upon either the sale or lease of the premises. Paragraph five of that agreement states in relevant part: "Broker earns its commission . . . if during the term of this Agreement: (a) a prospective buyer or lessee is ready, willing and able to PURCHASE or EXCHANGE or LEASE the Property at the price shown in paragraph 4 above, or at any other price or terms acceptable to Owner; or (b) any contract for the SALE or TRANSFER or LEASE of the Property or any portion thereof or interest therein is entered into by Owner; or (c) Owner and a prospective buyer or tenant enter into a legally binding contract for the SALE or EXCHANGE or LEASE of the Property or any portion thereof or any interest therein and such contract is breached or rescinded by a party or the parties; or (d) Owner SELLS, LEASES or TRANSFERS the Property or any portion thereof or interest therein" Paragraph four states: "Owner authorizes Broker to quote a SALE/EXCHANGE price of: \$500,000, and a lease rental price of \$13.50 gross per square foot, per annum."

[¶14] Given the substance of the parol evidence admitted in the present case, it might be supposed that Schwartz was attempting to establish that the lease term contained in the agreement was the result of either mistake or misrepresentation. We refer specifically to Schwartz's testimony that he asked Tully whether the 1997 contract was the same as the 1995 sale-exchange agreement. Schwartz testified that Tully replied that it was essentially the same and that it contemplated only the sale of the subject property.

[¶15] As stated previously, parol evidence may be introduced to show fraud in the inducement or a mistake in memorializing the terms of an agreement. Where fraudulent

* In looking to the circumstances surrounding the making of the agreement, the court relied on *Lar-Rob Bus Corp. v. Fairfield*, 170 Conn. 397, 407-408, 365 A.2d 1086 (1976). *Lar-Rob Bus Corp.* did not involve a situation in which the trial court relied on parol evidence to contradict the express terms of a written contract. Rather, the court relied on such evidence only to resolve an ambiguity in the contract's language. * * * *

misrepresentation is alleged, parol evidence may be introduced to show that the legal effect of a term was misrepresented and that such misrepresentation was relied on by a party in signing the agreement. See *id.* The pleadings filed in the present case, however, preclude any such application of the parol evidence rule. The only special defense that the defendants raised was the assertion that the contract failed to comply with the provisions of [a statute requiring real estate brokers to serve only pursuant to a written contract]. The defendants did not raise any issue with respect to mistake or fraud.* Even if we were to conclude that Schwartz's testimony at trial was aimed at establishing fraud or misrepresentation by the plaintiff respecting the terms of the agreement, we could not conclude that the court was entitled to entertain such testimony. Fraud is an affirmative defense that to be availed of, must specifically be pleaded. * * * * Because it was not pleaded, the defendants are not entitled to a judgment premised on that defense even if the evidence supports a finding of fraud. * * * *

[¶16] We conclude, therefore, that the court's reliance on parol evidence to contradict an express term of the parties' contract was improper. Accordingly, we reverse the court's judgment that the brokerage agreement did not cover the leasing of the property. * * * *

[¶17] The judgment is reversed and the case is remanded for further proceedings (1) to consider the defendants' special defense relating to § 20-325a (b) and (2) for a determination of the appropriate amount of damages.

In this opinion the other judges concurred.

Questions:

1. What did the trial court do wrong?
2. Why doesn't the court allow evidence of either mistake in transcription or fraud?
3. Had the contract been ambiguous, would Tully's response have been admissible?
4. Should the phone conversation between Tully and Schwartz matter?
5. Is there anything in the parol evidence rule about ambiguity? Plain meaning?
6. What public policy might support the parol evidence rule?

* Although the defendants pleaded a counterclaim against the plaintiff, alleging a violation of the Connecticut Unfair Trade Practices Act, General Statutes § 42-110a et seq., the court found that the defendants had failed to brief that claim and deemed it to be abandoned.

7. Why is the parol evidence rule “not an exclusionary rule of evidence, however, but a rule of substantive contract law”? Why then do we call it an “evidence rule”?

8. The court mentions the “four corners of the contract” in its description of the parol evidence rule. Would the parol evidence rule exclude written evidence of Tully’s response?

Some written contracts are obviously final, and some are obviously final and complete. Some are not obviously final. Some are obviously not complete. For example, thousands of cases involve homeowners who hire contractors to do yard projects, and the writing at issue is only a signed bid. It might be final, but it is obviously not complete. Can the court consider evidence besides the written document to determine whether the written document is final and/or complete?

Bennie D. HERRING v. Hubert M. PRESTWOOD, Jr., et al.
Supreme Court of Alabama (1979), 379 So.2d 548

TORBERT, Chief Justice.

[Excerpt from the Opinion:

[¶1] Appellant, Bennie Herring, filed suit below for a declaratory judgment to define the terms of an option to purchase land from the appellees, Hubert and Mary Prestwood. The option granted Herring the right to purchase 320 acres of land from the Prestwoods for a purchase price of \$208,000 consisting of a down payment of \$96,000 with the balance of \$112,000 to be paid in annual installments over a period of ten to twenty years with interest at 8%. The evidence is in dispute as to whether any consideration was paid for the option.

[¶2] The first amendment to the complaint reworded the complaint to allege that the written option did not reflect the total agreement of the parties and added two counts to the complaint, one for breach of contract in refusing to convey, the other for fraud. Herring insists that the written option agreement is incomplete because it does not contain that portion of the actual agreement which would allow Herring to use the 320 acres as security for a loan to pay the down payment. The Prestwoods filed a motion to strike those allegations of the complaint which referred to the alleged oral promise and that motion was granted by the court because that court found proof of those allegations would be inadmissible.]

ON APPLICATION FOR REHEARING

[¶3] On application for rehearing the opinion is extended to address the parol evidence rule issue, in order to give the trial court guidance on remand.

[¶4] We hold that the trial court committed reversible error in finding that the parol evidence rule barred any testimony to the effect that the written option did not reflect the total agreement of the parties. The appellant contends that the entire agreement of the parties included the seller's agreement to allow him to place a first mortgage on the property. The appellee contends that the entire agreement included the buyer's agreement to abstain from placing any encumbrance on the property which would impair the vendor's lien. The written option is silent as to first mortgages. Because the writing does not cover the issue of first mortgages, parol evidence is admissible to establish the agreement of the parties.

The parol evidence rule, therefore, does not apply to every contract of which there exists written evidence, but applies only when the parties to an agreement reduce it to writing, And agree or intend that the writing shall be their complete agreement. [Citations omitted.] Where there exists doubt that the written agreement was ever intended to reflect the full agreement of the parties, the courts of this State have not hesitated to admit contradictory parol evidence. [Citations omitted.] *Hibbett Sporting Goods v. Biernbaum*, 375 So.2d 431 (Ala.1979) (emphasis added).

[¶5] This writer expressed his understanding of the parol evidence rule in a dissenting opinion in *Hibbett Sporting Goods*, *supra*. There he disagreed with the majority because the specific issue about which the admission of parol evidence was sought had been covered in the writing. In the instant case, the writing was completely silent as to first mortgages or vendor's liens.

It is fundamental that the parol evidence rule prohibits the contradiction of a written agreement by evidence of a prior oral agreement. The rule provides that when the parties reduce a contract to writing, no extrinsic evidence of prior or contemporaneous agreements will be admissible to change, alter, or contradict such writing. *Hartford Fire Insurance Co. v. Shapiro*, 270 Ala. 149, 117 So.2d 348 (1960); *Richard Kelley Chevrolet Co. v. Seibold*, 363 So.2d 989 (Ala.Civ.App.1978); 3 A. Corbin, *Corbin on Contracts* § 573, at 357 (1969). When the writing is a final expression of the parties' agreement, it is said to be integrated. If the writing is final but not complete, it is partially integrated and consistent terms only can be supplied by extrinsic evidence. If the writing is final and complete, it is totally integrated and not even evidence of consistent terms can be admitted. J. Murray, Jr., *Murray on Contracts* § 105 (1974); J. Calamari & J. Perillo, *The Law of Contracts* § 40, at 76 (1970). Whether the instrument is a final and complete expression of the agreement is to be determined from the conduct and language of the parties, the surrounding circumstances, and the instrument itself. *Southern Guaranty Insurance Co. v. Rhodes*, 46 Ala.App. 454, 243 So.2d 717 (1971); *Pasquale Food Co. v. L & H International Air, Inc.*, 51 Ala.App. 127, 283 So.2d 438 (1973); 9 J. Wigmore, *Evidence* § 2430, at 98 (3d ed. 1940). In making such a determination, "the chief and most satisfactory index for the judge is found in the circumstance whether or not the particular element of the alleged extrinsic negotiation is dealt with at all in the writing. If it is mentioned, covered, or dealt with in the writing, then presumably the writing was meant to represent all of the

transaction on that element; if it is not, then probably the writing was not intended to embody that element of the negotiation." *Id.* at 98-99; *Southern Guaranty Insurance Co. v. Rhodes*, *supra*.
Hibbett Sporting Goods v. Biernbaum, 375 So.2d at 437 (Ala.1979).

[¶6] Since the written option in the instant case was silent as to vendor's liens or first mortgages, it does not embody that element of the negotiation and parol evidence is admissible to establish the understanding or agreement of the parties in regard to a first mortgage.

OPINION EXTENDED; APPLICATION FOR REHEARING OVERRULED.
BLOODWORTH, FAULKNER, ALMON and EMBRY, JJ., concur.

Questions:

1. Do you find it odd that the court considers the alleged extraneous provisions in order to determine whether the contract is integrated? Not every court is willing to do this. Consider the following from *State ex rel. MHTC v. Maryville Land Partnership*, 62 S.W.3d 485 (Mo. App. 2001):

[¶1] The parol evidence rule has been described as "a deceptive maze rather than a workable rule." *Jake C. Byers, Inc. v. J.B.C. Investments*, 834 S.W.2d 806, 812 (Mo. App. E.D.1992). There is a general consensus that when the parties have reduced their final and complete agreement to writing, the parol evidence rule does not permit the writing to be varied or contradicted and this principle is a substantive rule of law and not a rule of evidence. *Id.* (citing *Commerce Trust Co. v. Watts*, 360 Mo. 971, 231 S.W.2d 817, 820 (1950)); Restatement (Second) Contracts § 213. The parol evidence rule does not prevent relevant parol evidence from being admitted; but prohibits the trier of fact from using that evidence to vary, alter or contradict the terms of a binding, unambiguous and integrated written contract. Restatement (Second) Contracts § 214. The essence of the parol evidence rule is, therefore, that evidence outside a completely integrated contract cannot be used to change the agreement.

[¶2] The parol evidence rule does not, however, prohibit the presentation of parol evidence to determine *if* the contract is integrated. All authorities agree that the court must determine if the contract is integrated before it applies the parol evidence rule. *Wulfing v. Kansas City Southern Industries, Inc.*, 842 S.W.2d 133, 146 (Mo. App. W.D.1992); Restatement (Second) Contracts § 209. A written agreement is integrated if it represents a final expression of one or more terms of the agreement. Restatement (Second) Contracts § 209(1). Contracts can be either completely or partially integrated. If a written contract is a completely integrated agreement even consistent additional terms within its scope are precluded. *Centerre Bank of Kansas City v. Distributors*, 705 S.W.2d 42, 51 (Mo. App. W.D.1985); Restatement

(Second) Contracts § 209 (cmt.a). If, however, the writing omits a consistent additional term that is either agreed to for separate consideration or might naturally have been omitted in the circumstances, the agreement is considered only partially integrated and collateral facts and circumstances may be introduced to prove consistent additional terms. *Craig v. Jo B. Gardner, Inc.*, 586 S.W.2d 316, 324 (Mo. banc 1979); Restatement (Second) Contracts § 216(2).

[¶3] Scholars disagree, however, on the method by which courts should determine if the contract is integrated. Compare 4 WILLISTON, CONTRACTS § 633 (3rd ed.1961) and 1 Restatement, Contracts, §§ 237, 240, with 3 Corbin, Contracts § 582 (1960), Restatement (Second) Contracts § 209 and UCC 2-202; see generally, Farnsworth, Contracts § 7.3. Williston's position is that "the contract must appear on its face to be incomplete in order to permit parol evidence of additional terms." 4 Williston, Contracts § 633. If the contract appears on its face to be completely integrated, the court should simply accept that this is so, without looking to the surrounding circumstances. *Id.* The modern trend has been to reject this view on the ground that a "writing cannot prove its own completeness and accuracy." Corbin, *The Parol Evidence Rule*, 53 Yale L.J. 603, 630 (1944). Corbin, the Second Restatement, and the UCC have all taken the position that the court should take into consideration all relevant circumstances before determining that the contract is integrated. 3 Corbin, Contracts § 582; Restatement (Second) Contracts § 209 (cmt.b); UCC 2-202 Cmt. 1.

[¶4] The Missouri Supreme Court has not spoken to the question; but the language used in its decisions has led this court to adopt the position advocated by Williston and the First Restatement. *Jake C. Byers, Inc.*, 834 S.W.2d at 811-12. So, the initial inquiry is to determine if the Escrow Agreement here is completely or partially integrated on its face. Under present Missouri law, if it is a complete agreement on its face, it is conclusively presumed to be a final as well as a complete agreement between the parties. *Id.* at 812. We look to the Escrow Agreement and find the following relevant provisions:

THIS ESCROW AGREEMENT, made and entered into as of this 31st day of October, 1985 by and between Lindbergh-Warson Properties, Inc. ("Lindbergh"), and Maryville Land Partnership, a Joint Venture ("Maryville"), the Missouri Highway and Transportation Commission ("Commission"), Community Title Company ("Community") and Centerre Bank, National Association ("Bank").

WHEREAS, Lindbergh and the Commission heretofore entered into a certain Agreement . . . wherein Lindbergh agreed to pay a sum not exceeding One Million and no/100 Dollars (\$1,000,000.00) in reimbursement of the Commission for the actual construction cost of the Grade Separation and the North Outer Roadway on Highway 40 in St. Louis County, Missouri,

approximately midway between Route 141 and the Mason Road interchange; and

WHEREAS, Lindbergh and the Commission heretofore entered into a supplemental agreement wherein Lindbergh agreed to pay an additional sum of Ninety Thousand and no/100 (\$90,000.00) for certain "culvert work"; and

WHEREAS, Maryville, of which Lindbergh is a general partner, has heretofore succeeded to the rights and obligations of Lindbergh in the Agreement; and

WHEREAS, Bank has heretofore loaned to Maryville the monies necessary to fund Maryville's obligations to the Commission under the Agreement and in connection therewith Bank agreed to advance the proceeds of said loan at the request of, and at the direction of, the Commission upon receipt from the Commission of its certification that (a) the cost of the overpass and culvert work completed to date, as a percentage of the total projected cost of said work, is not less than the amount previously disbursed plus the amount of the requested advance, expressed as a percentage of Maryville's total obligation to Commission and (b) all previous advances have been used to satisfy Maryville's obligation to partially defray the costs of the culvert and overpass work (the "Certification") and

WHEREAS, Bank would like to be relieved of its direct obligation to the Commission in this regard and the parties hereto are mutually agreed that Community shall serve as the Escrow Agent pursuant to the terms hereinafter specified. . . .

NOW, THEREFORE, in consideration of the promises and of the mutual covenants and agreements hereinafter set forth, and of other good and valuable consideration, the parties hereto covenant and agree as follows:

1. *Escrowed Funds.* Maryville shall, upon execution of the Escrow Agreement, cause to be deposited with Community the sum of One Million Thirty Four Thousand Five Hundred Sixty and no/100 Dollars (\$1,034,560.00), being the balance of Maryville's obligation to Commission (the "Escrowed Funds"), to secure the obligations of Maryville under the Agreement. . . .

2. *Investment.* The Escrowed Funds shall be invested in Certificates of deposit with Bank in such amounts and with such maturity dates as Maryville shall direct.

3. *Escrow Funds.* The Escrowed Funds shall be advanced as directed by Commission within five (5) business days of receipt of the written request of the Commission. Each such

request shall be accompanied by a Certification in the form annexed hereto as Exhibit B. . . .

* * * * *

5. *Accumulation of Income.* All income accumulated from the investment of the Escrowed Funds and not used to satisfy interest or other loan charges, if any, shall be the property of Maryville and shall be paid to Maryville, from time to time, upon request.

[¶5] The Escrow Agreement simply makes no reference to what would happen to any unused funds in the escrow account, but recitals in the Escrow Agreement reference both the Construction Agreement and a supplemental agreement. These references show that the fundamental purpose of the Escrow Agreement was to facilitate the Construction Agreement by replacing Lindbergh-Warson's letter of credit with an escrow account furnished by Maryville Land, who had succeeded to Lindbergh Warson's interests. The face of the Escrow Agreement itself makes clear that a number of documents, read together, make up the entire agreement between the Commission, Lindbergh-Warson and Maryville Land. The Escrow Agreement merely supplements terms in the underlying Construction Agreement and does not represent the entire agreement of the parties. Importantly, it does not provide for the possibility that the parties would succeed in obtaining state and federal funds for the construction of the overpass. We therefore conclude that the Escrow Agreement was not a completely integrated agreement and collateral facts and circumstances could be introduced to show consistent additional terms. *See Craig v. Jo B. Gardner, Inc.*, 586 S.W.2d 316, 324 (Mo. 1979). The court did not err in allowing evidence to show that the parties' agreement assumed that Maryville Land would be entitled to a return of the escrowed funds if MHTC obtained state and federal funding. MHTC's first and third points of error therefore fail.

2. Had the *MHTC* court followed the Corbin rule, what evidence would you expect the parties to have offered? Would use of the Corbin rule have changed the result? Justice Traynor, in *Masterson v. Sine*, 436 P.2d 561, 565 (Cal. 1968), wrote:

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, s 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.
Who resolves parol evidence questions—judge or jury? Does Corbin’s suggestion conflict with what you learned from *Colliers, Dow & Condon, Inc.* about the parol evidence rule’s underlying policy?

3. Doesn’t the *MHTC* court stop the analysis of integration a bit early? If the Escrow Agreement was supposed to function in tandem with the Construction Agreement and a supplemental agreement, shouldn’t the question be whether these three agreements were integrated?

4. The use of recitals in the *MHTC* Escrow Agreement is pretty standard. What is the role or function of the recitals in this contract?

Uniform Commercial Code § 2-202

Alvin SNYDER, Morris Sugarman, Herbert Thaler and Harold A. Crone, Inc. and T/A Twin Lakes Partnership v. HERBERT GREENBAUM AND ASSOCS., INC.
Maryland App. (1977), 380 A.2d 618

COUCH, J., delivered the opinion of the Court.

[¶1] This is an appeal from a judgment entered in the Circuit Court for Baltimore County (LAND, J.), sitting without a jury, in favor of appellee, Herbert Greenbaum and Associates, Inc., and against Alvin Snyder, Morris Sugarman, Herbert Thaler, and Harold A. Crone, individually and trading as Twin Lakes Partnership.

[¶2] Appellants raise three contentions in this appeal:

(I) The trial court erred in its findings that the appellants were not entitled to rescind the contract because appellee had misrepresented a material fact, which appellants relied on in forming the contract;

(II) The trial court erred in not allowing into evidence certain documents as proof of a prior oral agreement that all contracts between the parties, including the one at issue in this case, could be cancelled unilaterally prior to performance;

(III) The trial court erred in the assessment of damages.

[¶3] The facts that give rise to this dispute are simple. Pursuant to its plan to begin construction in 1973 of 228 garden apartments, Twin Lakes, through its management, began negotiations with the appellee, Herbert Greenbaum and Associates, Inc., to supply and install carpeting and the underlying carpet pad for the apartments. During the course of these negotiations Greenbaum estimated that approximately 19,000 to 20,000 yards of carpeting were required for the job. Thereafter the parties entered into a contract that

Greenbaum would supply the necessary carpet for the 228 apartments, and install it, for a total consideration of \$87,600.00. In the contract itself no mention was made of the amount of carpeting to be installed.

[¶3] Between the April 4, 1972 date of the contract and September, 1973, Greenbaum purchased large amounts of carpet to be used on the Twin Lakes job from several carpet wholesalers. However, no carpet was ever installed because Twin Lakes, through Alvin Snyder, cancelled the contract in September, 1973. It became apparent at some point that 19,000 to 20,000 yards of carpet was an overestimation — the actual figure needed was between 17,000 and 17,500 yards.

[¶4] Appellee then brought an action against the Twin Lakes Partnership for breach of contract, and was awarded a judgment for \$19,407.20. It is this judgment from which this appeal stems.

[¶5] Before considering the points raised by the appellants, an important threshold question must be answered — whether *Md. Code* (1974), Commercial Law Article, specifically Title 2, Maryland Uniform Commercial Code — Sales, applies to the contract in this case, which is a mixed contract for the sale of carpet and the installation of the carpet. * * * * [The court concluded that Article 2 indeed applied.]

II

[¶6] At trial appellants offered five documents, purporting to be prior contracts between the parties, each one bearing on its face a notation that it was rescinded or cancelled. Appellants offered these contracts as proof of a prior course of dealing or oral agreement between appellants and appellee to the effect that either party could cancel or modify any contract between these parties unilaterally. Therefore, the appellants contend that they had a contractual right to rescind, and are not liable for breach of contract.

[¶7] The trial court refused to admit these documents, relying chiefly on the parol evidence rule. Appellants contend that the trial court erred in refusing to admit these documents.

[¶8] As a result of our holding that the Sales Title applies to this contract, the parol evidence rule, as found in *Md. Code* (1974), Commercial Law Article § 2-202, governs this case. That section provides:

"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 (§ 1-303) or by course of performance * * * ; 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."

[¶9] By the terms of § 2-202 itself, § 2-202 applies to the contract in this case. This contract was made after negotiations between the parties, and intended to be a final expression of their agreement with respect to the terms embodied therein.

[¶10] However, the course of dealing or agreement which appellants attempted to show does not directly contradict any of the terms expressed in the writing. There is no expression concerning cancellation or rescission in the contract. The terms of the agreement, therefore, may be "explained or supplemented" as allowed by subsections (a) or (b).

[¶11] Subsection (a) provides for the admission of extrinsic evidence showing a "course of dealing" between the parties. "Course of dealing" is defined in [§ 1-303(b)] as:

"[A] sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct."

[¶12] The import of [§ 1-303(b)] is that "course of dealing" is an interpretive device to give meaning to the words and terms of an agreement. This function is underlined by Comment 2 of the Official Comment to § 2-202, which notes that:

"Paragraph (a) makes admissible evidence of course of dealing . . . 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 Unless carefully negated they have become *an element of the meaning of the words used*." (Emphasis added.)

See State ex rel. Yellowstone Park Co. v. District Court, 160 Mont. 262, 502 P.2d 23 (1972).

[¶13] That which appellants advance as a "course of dealing" does not serve as an interpretive device, but as an agreement that adds terms to the contract. Therefore, the evidence offered does not properly fall under the rubric of "course of dealing", but is properly under the requirements of Subsection (b) of § 2-202, dealing with "additional terms". *See Division of Triple-T Service v. Mobil Oil Corp.*, 60 Misc.2d 720, 304 N.Y.S.2d 191 (1969).*

[¶14] Subsection (b) allows evidence of additional terms subject to two prerequisites to admission. The first is that the writing or contract must not be found by the court to have

* Triple-T holds that a custom or usage of the trade and/or a course of dealing are in essence covered by the essential requirement of "additional terms" — that it be consistent. The practical effect is to restrict a "course of dealing" to being an interpretive device, unless § 2-202 (b) is resorted to.

been intended as a complete and exclusive statement of the contract terms. Second, the "additional terms" must not be inconsistent with the contract and its terms.

[¶15] Comment 3 of the Official Comment to § 2-202 explains the first requirement as: "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 nature of the additional term that appellants sought to prove at trial, allowing unconditional unilateral rescission, is such a term that would have been included in the final written agreement, and was correctly excluded by the trial judge. A term allowing unilateral cancellation would certainly have been included in the contract, given the nature of appellee's obligation. Appellee was required to take substantial preparatory steps to performance, such as the purchase of the carpet. To protect this obligation, any term allowing unilateral cancellation by appellee, had there been such a term, would have included an express qualification as to the time of cancellation. Certainly the cancellation term would have been included in the writing to evidence appellee's ability to cancel at *any* time. We conclude that the contract was intended to be a complete and exclusive statement of the contract terms and, therefore, the evidence of additional terms was properly excluded.

[¶16] 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.

[¶17] 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, 341 A.2d 417 (1975).

[¶18] 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, 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.

Questions:

1. Does the parol evidence rule as stated in § 2-202 differ from the common law parol evidence rule stated in *Colliers, Dow and Condon, Inc.*?
2. On what evidentiary showing does the court conclude that the agreement was intended to be a final expression of the parties' agreement?
3. First, in ¶ 10, the court rules that the proposed evidence does not contradict the agreement. Then, later, the court seems to rule in a manner inharmonious with that ruling. Where? Do you follow the court's reasoning? Why does it work through the statute in this manner?
4. What role does the sentence in comment 3 play in the court's interpretation of the statute?
5. Is this contract partially integrated? Fully integrated?
6. Did the court reach the right result?

PROBLEM 2: A signs an option agreement requiring A at B's election to sell certain paintings to B at a given price for a certain period of time. Later, A contends that the option cannot be exercised unless A first receives an offer from C to buy the paintings. Is the second assertion consistent with the option?

PROBLEM 3: A printing company agrees in writing to print twelve monthly issues of a magazine for a publisher. The printing company prints the first issue very badly, however. The publisher fires the printer, and printer sues. In court, the magazine publisher wants to show that the two companies agreed informally and because it is trade usage that the publisher would have the right to terminate at any time it was not satisfied with the printing. Is that consistent?

Luther WILLIAMS, Jr. v. JOHNSON
D.C. Court of Appeals (1967), 229 A.2d 163

QUINN, J.

[¶1] Appellant (plaintiff below) sought to recover \$670 as liquidated damages under a contract for improvements on appellees' home. Appellees' defense was that the contract never came into existence because of an unfulfilled condition precedent. This appeal raises the sole question of whether the parol evidence rule required exclusion of all testimony regarding the alleged condition.

[¶2] At the trial, Luther Williams, Jr., president of appellant corporation, testified that prior to the signing of the contract, he offered to arrange any necessary financing for appellees, but was advised that they had their own. He was further informed that the down payment would be made in a few days when they received their funds. After drawing plans and contacting appellees several times, he was told that their financing had not been obtained and that they had procured another contractor to make certain improvements on the property.

[¶3] Appellees testified that they signed the contract thinking it was merely an estimate; that they told Mr. Williams the improvements would depend upon approval of their financing by their bank; and that it was their understanding with him that they would not become obligated until they had procured the funds. Appellant objected to the introduction of all testimony concerning a parol agreement regarding financing, and later objected to jury instructions on that subject. The objections were overruled, and the jury returned a verdict for appellees.

[¶4] As previously stated, the issue here is a narrow one, namely, whether the admission of testimony concerning the oral condition precedent violated the parol evidence rule. Briefly stated, that rule provides that when the parties to a contract reduce their agreement to writing, that writing is presumed to be the final repository of all prior negotiations, and testimony concerning prior or contemporaneous oral agreements which tends to vary, modify or contradict the terms of the writing is inadmissible. See 3 Corbin, Contracts § 573 (1960); 4 Williston, Contracts § 631 (3d ed. 1961).

[¶5] In this jurisdiction, however, it is well settled that a written contract may be conditioned on an oral agreement that the contract shall not become binding until some condition precedent resting in parol shall have been performed. *Burke v. Dulaney*, 153 U.S. 228, 14 S.Ct. 816, 38 L.Ed. 698 (1894); *Lippincott v. Kerr*, 59 App.D.C. 290, 40 F.2d 802 (1930); *Robertson v. Ramsay*, 54 App.D.C. 346, 298 F. 557 (1924); *Northeast Motor Co. v. Neal*, D.C. Mun.App., 162 A.2d 287 (1960); *Jess Fisher & Co. v. Darby*, D.C.Mun.App., 96 A.2d 270 (1953); *Wetzel v. DeGroot*, D.C. Mun.App., 86 A.2d 737 (1952); *Glascoe v. Miletich*, D.C.Mun.App., 83 A.2d 587 (1951). Furthermore, parol testimony to prove such a condition is admissible when the contract is silent on the matter, the testimony does not contradict nor is it inconsistent with the writing, and if under the circumstances it may properly be inferred that the parties did not intend the writing to be a complete statement of their transaction. *Seitz v. Brewers' Refrigerating Mach. Co.*, 141 U.S. 510, 12 S.Ct. 46, 35 L.Ed. 837 (1891); *Jess Fisher & Co. v. Darby*, *supra*; *Glascoe v. Miletich*, *supra*; *Mitchell v. David*, D.C.Mun.App., 51 A.2d 375 (1947).

[¶6] The contract in question contained the following clause:
"This contract embodies the entire understanding between the parties, and there are no verbal agreements or representations in connection therewith."

Two problems thus arise when applying the above rules to the instant case. First, in the light of an "integration clause," can evidence be admitted to show that the parties did not

intend the writing to be a complete statement of their transaction? Second, can it be said that the testimony regarding the condition precedent does not contradict the writing when the contract states there are no agreements other than those contained in the writing?

[¶7] As to the first question, it has always been presumed that a written contract is the final repository of the agreement of the parties. 4 Williston, op. cit. supra § 631 at 953-954. In this regard, an integration clause merely strengthens this presumption. However, intent is a question of fact, and to determine the intent of the parties, it is necessary to look not only to the written instrument, but to the circumstances surrounding its execution.

[¶8] In *Mitchell v. David*, supra, we quoted with approval from 9 Wigmore, Evidence § 2430 (3d ed. 1940) as follows:

"Whether a particular subject of negotiation is embodied by the writing depends wholly upon the intent of the parties thereto. In this respect the contrast is between voluntary integration and integration by law. Here the parties are not obliged to embody their transaction in a single document; yet they may, if they choose. Hence it becomes merely a question whether they have intended to do so." "This intent must be sought where always intent must be sought, namely, in the conduct and language of the parties and the surrounding circumstances. 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. Thus the apparent paradox is committed of receiving proof of certain negotiations in order to determine whether to exclude them; and this doubtless has sometimes seemed to lower the rule to a quibble. But the paradox is apparent only. The explanation is that these alleged negotiations are received only provisionally. Although in form the witnesses may be allowed to recite the facts, yet in truth the facts will be afterwards treated as immaterial and legally void, if the rule is held applicable. There is a preliminary question for the judge to decide as to the intent of the parties, and upon this he hears evidence on both sides; his decision here, pro or con, concerns merely this question preliminary to the ruling of law. If he decides that the transaction was covered by the writing, he does not decide that the excluded negotiations did not take place, but merely that if they did take place they are nevertheless legally immaterial. If he decides that the transaction was not intended to be covered by the writing, he does not decide that the negotiations did take place, but merely that if they did, they are legally effective, and he then leaves to the jury the determination of fact whether they did take place." 51 A.2d at 378.

See also, *Giotis v. Lampkin*, D.C.Mun.App., 145 A.2d 779 (1958); 3 Corbin, op. cit. supra § 582. We are still of the opinion that this expresses the better practice.

[¶9] As to the second question, we are aware that some courts have answered it in the negative. See, e. g., *Rowe v. Shehyn*, 192 F. Supp. 428 (D.D.C.1961); *J & J Construction*

Co. v. Mayernik, 241 Or. 537, 407 P.2d 625 (1965). We believe, however, that this is an erroneous interpretation of Restatement, Contracts § 241 (1932) which provides as follows:

"Where parties to a writing which purports to be an integration of a contract between them orally agree, before or contemporaneously with the making of the writing, that it shall not become binding until a future day or until the happening of a future event, the oral agreement is operative if there is nothing in the writing inconsistent therewith." (Emphasis added.)

To explain this section, the following illustration is given:

"A and B make and sign a writing in which A promises to sell and B promises to buy goods of a certain description at a stated price. The parties at the same time orally agree that the writing shall not take effect unless within ten days their local railroad has cars available for shipping the goods. The oral agreement is operative according to its terms. If, however, the writing provides 'delivery shall be made within thirty days' from the date of the writing, the oral agreement is inoperative."

In our opinion, it is clear from the example that what is intended is not the exclusion of evidence because of the existence of an "integration clause," 3 Corbin, op. cit. supra § 578 at 405-407, but an exclusion only if the alleged parol condition contradicts some other specific term of the written agreement. See *Fadex Foreign Trad. Corp. v. Crown Steel Corp.*, 272 App.Div. 273, 70 N.Y.S.2d 892, aff'd, 297 N.Y. 903, 79 N.E.2d 739 (1947); 3 Corbin, op. cit. supra § 577 example (5). In the instant case, no provision was made regarding financing. Therefore, the parol condition would not contradict the terms of the writing.

[¶10] For the above-stated reasons, we hold that it was not error to admit testimony tending to show that the writing was not intended to be a complete statement of the agreement of the parties and to instruct the jury to find for appellees if they determined that the negotiations regarding the condition precedent had taken place and that the contract was not to become binding unless the financing was first obtained.

Affirmed.

Questions:

1. Is the integration clause conclusive?
2. Is the integration clause consistent with the oral condition?
3. Evidence submitted to prove a contract void or voidable—fraud, mistake, duress, illegality, etc.—is admissible notwithstanding the parol evidence rule. Why?
4. Conditions—you probably studied them when you studied illusory promises. Understanding them depends on seeing what it is that they make conditional. Can you discern the difference between a condition of a contract and a condition of a duty? Would the latter prevent a contract from forming?

RIGGS BANK, N.A. v. Edward J. HARRIS, Jr., et al.
D. Md. (2000)

MEMORANDUM

[¶1] Riggs Bank has brought this action against Edward J. Harris, Jr. and Andre Downey to collect on guaranties executed by defendants with respect to a commercial term loan in the original principal amount of \$500,000 made to Abatement Environment Resources, Inc. (“AER”). AER, which is now in bankruptcy, defaulted on the loan. Proper demand for payment has been made upon AER and upon defendants. After defendants refused to pay, Riggs filed this action and moves for summary judgment.

[¶2] Defendants assert that the loan made to AER was to finance the sale of AER to themselves. They further allege that their guaranties were subject to an oral condition precedent that this sale would close.

[¶3] Under the law of the District of Columbia—which the parties appear to agree is governing—where the parties’ intentions are “clear, unambiguous and not ‘reasonably or fairly susceptible of different constructions or interpretations, or of two or more different meanings,’ . . . no evidence may be introduced of prior agreements or terms, whether consistent or inconsistent, within the scope of the written agreement.” *Bolle v. Hume*, 619 A.2d 1192, 1196 (D.C. 1993) * * * .

[¶4] Here, the guaranties executed by defendants contained an integration clause providing that:

This Guaranty, together with any Related Documents, constitutes the entire understanding and agreement of the parties as to matters set forth in this Guaranty. No alteration of or amendment of this this Guaranty shall be effective unless given in writing and signed by the party or parties sought to be charged or bound by the alteration or amendment.

Each of the guaranties also provided that it “would take effect when received by Lender [Riggs]” Nothing in the related loan documents suggests that the oral condition precedent alleged by defendants existed. To the contrary, the only condition precedents mentioned in the loan documents were in favor of Riggs. The commitment letter conditioned Riggs’ obligations upon the execution of a management agreement between defendants and Joseph Downey, the owner of AER, and the business loan agreement between Riggs and AER conditioned Riggs’ obligations under the loan upon Riggs’ receipt of defendants’ guaranties.

[¶5] Defendants rely upon an exception to the parole evidence rule permitting extrinsic evidence that a contract containing unconditional obligations was not itself to become effective until an oral condition precedent had been met. As a matter of abstract logic, this

exception could virtually swallow the rule. Therefore, its parameters must be judged by the context in which it has been articulated.

[¶6] The three cases cited by defendants in which the exception was applied are clearly different from the present case. Two of them, *Williams v. Johnson*, 229 A.2d 163 (D.C. 1967) and * * * involved consumer transactions and presented factual disputes as to whether the party seeking to enforce the contract had been guilty of heavy-handed treatment if not outright fraud. * * * *

[¶7] It might appear that the easy way to avoid a collision between the parole evidence rule and the “oral condition precedent” exception to the rule relied upon by defendants would be to deny Riggs’ motion for summary judgment and permit discovery to proceed. That course would, however, result in substantial litigation expense and at least some delay. It would thus defeat the very purpose of the parole evidence rule “to promote the stability of transactions by preventing disgruntled parties from avoiding obligations by alleging oral understandings that conflict with their written agreement when those agreements were reduced to writing in order to forestall just such contentions.” * * * *

[The court refused to allow discovery and granted Riggs Bank summary judgment on the issue of defendant’s liability.]

Question: What is going on here?

C. Implied Obligations

Even while contract law takes words seriously, the law also recognizes that the words used in a contract could not possibly include everything the parties mean to say. Our inability to specify obligations with perfect completeness sometimes tempts people to read their contracts in a wooden or technical way in favor of their own positions. Non-lawyers call such a reading “finding a loophole.” But the duties of cooperation and good faith ensure that the bargain’s substance is enforced notwithstanding the incompleteness of our contracts.

In the following cases, what did the parties fail to promise to do, or not do, specifically that a judge later decides to include in one party’s obligation? Do you feel safer making contracts, generally speaking—are you more willing to become a contracting party—because you know courts may add specificity to your or your counter-party’s contractual obligations under the duty of cooperation or the duty of good faith?

1. Duty of Cooperation

PATTERSON v. MEYERHOFER
Court of Appeals of New York (1912), 97 N.E. 472

WILLARD BARTLETT, J.

[¶1] The parties to this action entered into a written contract whereby the plaintiff agreed to sell, and the defendant agreed to buy, four several parcels of land with the houses thereon for the sum of \$23,000, to be partly in cash and partly by taking title subject to certain mortgages upon the property. When she executed this contract, the defendant knew that the plaintiff was not then the owner of the premises which he agreed to sell to her, but that he expected and intended to acquire title thereto by purchasing the same at a foreclosure sale. Before this foreclosure sale took place, the defendant stated to the plaintiff that she would not perform the contract on her part, but intended to buy the premises for her own account without in any way recognizing the said contract as binding upon her, and this she did, buying the four parcels for \$5,595 each. The plaintiff attended the foreclosure sale, able, ready, and willing to purchase the premises, and he bid for the same, but in every instance of a bid made by him the defendant bid a higher sum. The result was that she acquired each lot for \$155 less than she had obligated herself to pay the plaintiff therefor under the contract for \$620 less in all.

[¶2] In the foreclosure sale was included a fifth house, which the defendant also purchased. This was not mentioned in the written contract between the parties, but, according to the complaint, there was a prior parol agreement which provided that the plaintiff should buy all five houses at the foreclosure sale, and should convey only four of them to the defendant, retaining the fifth house for himself.

[¶3] Upon these facts the plaintiff brought the present action, demanding judgment that the defendant convey to him the fifth house, and declaring that he has a lien upon the premises purchased by her at the foreclosure sale, and that she holds the same in trust for the plaintiff subject to the contract. The complaint also prays that the plaintiff be awarded the sum of \$620 damages, being the difference between the price which the defendant paid at the foreclosure sale for the four houses mentioned in the contract and the price which she would have had to pay the plaintiff thereunder. The learned judge who tried the case at Special Term rendered judgment in favor of the defendant, holding that, under the contract of sale, there was no relation of confidence between the vendor and vendee. 'In the present case,' he said, 'each party was free to act for his own interest, restricted only by the stipulations of the contract.' He was, therefore, of the opinion that 'the defendant had a right to buy in at the auction, and that she is entitled to hold exactly as through she had been a stranger, and that the plaintiff is not entitled to recover the difference between the price paid at the auction and the contract price.'

[¶4] I am inclined to agree with the trial court that no relation of trust can be spelled out of the transactions between the parties. There is no finding of any parol agreement in respect to the fifth house which has been mentioned, and, even if there had been such an agreement resting merely in parol, I do not see that it would have been enforceable. As to the four parcels which constituted the subject-matter of the written contract, the defendant avowed her intention to ignore that contract before bidding for them, and cannot be regarded as having gone into possession under the plaintiff as vendor, but did so rather in defiance of any right of his * * * . * * * *

[¶5] There is no need of judicially declaring any trust in the defendant, however, to secure to the plaintiff the profit which he would have made if the defendant had not intervened as purchase at the foreclosure sale, and had fulfilled the written contract on her part. This is represented by his claim for \$620 damages. That amount, under the facts as found, I think the plaintiff was entitled to recover. He has demanded it in his complaint, and he should not be thrown out of court because he has also prayed for too much equitable relief.

[¶6] In the case of every contract there is an implied undertaking on the part of each party that he will not intentionally and purposely do anything to prevent the other party from carrying out the agreement on his part. This proposition necessarily follows from the general rule that a party who causes or sanctions the breach of an agreement is thereby precluded from recovering damages for its nonperformance or from interposing it as a defendant to an action upon the contract. *Young v. Hunter*, 6 N.Y. 203; *Barton v. Gray*, 57 Mich. 622, 24 N.W. 638, and cases there cited. 'Where a party stipulates that another shall do a certain thing, he thereby impliedly promises that he will himself do nothing which may hinder or obstruct that other in doing that thing.' *Gay v. Blanchard*, 32 La. Ann. 497.

[¶7] By entering into the contract to purchase from the plaintiff property which she knew he would have to buy at the foreclosure sale in order to convey it to her, the defendant impliedly agreed that she would do nothing to prevent him from acquiring the property at such a sale. The defendant violated the agreement thus implied on her part by bidding for and buying the premises herself. Although the plaintiff bid therefor, she uniformly outbid him. Presumably, if she had not interfered, he could have bought the property for the same price which she paid for it. He would then have been able to sell it to her for the price specified in the contract (assuming that she fulfilled the contract), which was \$620 more. This sum, therefore, represents the loss which he has suffered. It is the measure of the plaintiff's damages for the defendant's breach of contract.

[¶8] I see no escape from this conclusion. It is true that the contract contemplated that the four houses should go to the defendant and they have gone to her; but that is not all. The contract contemplated that they should go to the plaintiff first. In that event the plaintiff would have received \$620 which he has not got. This would have had to be paid by the defendant if she had fulfilled her contract; and she should be required to pay it now unless she can present some better defense than is presented in this record. This will place both

parties in the position contemplated by the contract. The defendant will have paid no more than the contract obligated her to pay. The plaintiff will have received all to which the contract entitled him. I leave the fifth house out of consideration because as to that it seems to me there was no enforceable agreement.

[¶9] For these reasons, the judgments of the Appellate Division and the Special Term should be reversed and a new trial granted, with costs to abide the event.

CHASE, J. (dissenting). [Omitted.] * * * *

Judgment reversed, etc.

Questions:

1. Did Patterson breach? The answer to this question is “yes,” but Patterson’s breach is excused for failure of a condition precedent. Under the doctrine of constructive conditions, which we will soon study, the law implies that the parties’ performances which are to occur simultaneously are conditions of each counterparties’ duty to perform. Meyerhofer’s duty of cooperation is to occur simultaneously with Patterson’s performance, so Meyerhofer’s performance of the duty of cooperation is deemed a constructive condition of Patterson’s duty. When Meyerhofer does not perform, Patterson’s performance does not become due, and Patterson’s failure to perform is excused.

2. What is the source of the duty to cooperate?

3. What was Meyerhofer thinking?

4. Should Meyerhofer be liable for the tort of interference with contractual relations? The “elements of a cause of action for tortious interference with contractual relations are (1) there was a contract subject to interference, (2) the act of interference was willful and intentional, (3) such intentional act was a proximate cause of plaintiff’s damage, and (4) actual damage or loss occurred.” *Juliette Fowler Homes, Inc. v. Welch Associates, Inc.*, 793 S.W.2d 660 (Tex. 1990).

PROBLEM 4: Hensel contracted to sell a house to Billman for \$54,000 cash. Billman gave a check for \$1,000 earnest money. “A condition of the contract was the ability of the buyers to secure a conventional mortgage on the property for not less than \$35,000 within thirty (30) days.” On the day following execution of the contract, Billman met with an agent of Lincoln Bank. The Bank told Billman that he “could not obtain a mortgage loan of \$35,000 unless he could show he had the difference between the purchase price and the amount of the mortgage. After totaling his available resources, including a 90-day short term note for \$10,000 representing the proceeds from the sale of his present home, Billman was \$6,500 short of the required \$19,000 balance.” Billman then invited his parents to tour the home. Billman’s father did not like the home. In the meantime, Hensel deposited the earnest

money check. Billman then told Hensel that he could not buy the house because he could not obtain a \$5,000 gift from his parents. Hensel replied that she would lower the price of the home by \$5,000. Billman then said he was still \$1,500 short. Billman did not deposit funds to cover the check and stopped payment on it. Billman then claimed to cancel the contract. Billman never contacted another financial institution and never formally applied for a loan. Hensel sued for the earnest money. Should she get it? Can you construct an argument based on *Patterson v. Meyerhofer*? *Billman v. Hensel*, 391 N.E.2d 671 (Ind. Ct. App. 1979).

Questions:

1. In *Seaward Construction Company, Inc. v. City of Rochester*, 383 A.2d 707 (N.H. 1978), Seaward Construction entered into a contract to install sewer pipe for the City at a rate of \$19 per foot for pipe installed 0-10 feet and \$60 per foot installed at 10-18 feet. The contract stated,

2. All monies due under the Contract are subject to the receipt of said monies by said Rochester Housing Authority from the Federal Housing and Urban Development Agency (HUD) and turned over to said City of Rochester for payment of the construction of said facilities.

5. The City of Rochester shall be under no legal obligation to advance any of its own funds for said construction.

6. Payment to said Seaward Construction Company, Inc. is contingent upon receipt of funds by the Rochester Housing Authority and turning same over to the City of Rochester for payment to said Seaward Construction Company.

Throughout the course of the contract, Seaward claimed funds for over 1,000 feet of pipe laid. The City paid most (920 feet worth) at a rate of \$19 over Seaward's objection that this pipe was installed lower than 10 feet deep. When Seaward filed a formal claim for the difference between \$19 and \$60 for the 920 feet, the City claimed that it had never received funds from HUD. No evidence showed that the City had applied for funds, however. The court stated:

In every agreement there exists an implied covenant that each of the parties will act in good faith and deal fairly with the other. *Griswold v. Heat Corporation*, 108 N.H. 119, 124, 229 A.2d 183, 187 (1967). The mere fact that the defendant is a city does not release it from this implied obligation to act in good faith and deal fairly with the plaintiff. See *Leary v. City of Manchester*, 90 N.H. 256, 257, 6 A.2d 760, 761 (1939). The express language in the agreement is perfectly clear that the city will not be required to expend its own funds for payment of the installation of the sewer line, but it is also reasonably clear that the city was under an implied obligation to make a good-faith effort to obtain funds from HUD to pay the plaintiff. *Rochester Park, Inc. v. City of Rochester*, 38 Misc.2d 714, 238 N.Y.S.2d 822, 826-27 (1963) aff'd 19 A.D.2d 776, 241 N.Y.S.2d 763 (1963). *Public Market Co. v. Portland*, 171 Or. 522, 588-89, 130 P.2d 624, 649-50 (1942).

The court held that, if Seaward showed that it had buried the pipe deeper than 10 feet, and the City had made no attempt to obtain funds, Seaward should be given judgment. Is there

any difference between Seaward Construction and Billman? Is there any difference between these two and Patterson?

2. What was the City thinking?

3. Why was the financing clause a condition precedent and not subsequent (in either *Billman* or *Seaward Constr. Co.*)?

4. For whose benefit is the “subject to financing” clause inserted?

5. If the purchaser doesn’t obtain financing but wants to and is able to close, anyway, can the purchaser do so? What argument suggests it can?

6. The buyer need not apply for a loan if the effort would be futile. In *Nicholls v. Pitoukkas*, 491 N.E.2d 574 (Ind. App. 1986), the financing condition stipulated that the buyer would apply for a loan within six days. The Pitoukkases, buyers, did not apply during that time. Their efforts thereafter were unsuccessful. The anticipated mortgage payment was \$719.58 per month. The Pitoukkases together had income of only \$806 per month. The court found, “Mr. and Mrs. Pitoukkas could not have obtained financing had they made ten timely and diligent applications for financing.” *Id.* at 575. Then the court explained, “It is this undisputed fact which distinguishes this case from *Billman v. Hensel* (1979), 181 Ind. App. 272, 391 N.E.2d 671. In *Billman* the evidence did not exclude the possibility a reasonable and good faith effort to obtain financing would have been successful.” *Id.* n.3.

7. What is the source of the duty here?

2. Good Faith

DESERT HERITAGE LIMITED PARTNERSHIP v. CITY OF TUCSON
Ariz. App. (2008)

HOWARD, Presiding Judge.

[¶1] Appellant Desert Heritage Limited Partnership appeals from the trial court’s grant of appellee City of Tucson’s motion for summary judgment on Desert Heritage’s claim that the City breached a lease by cancelling it and of the City’s motion to dismiss Desert Heritage’s claims of unpaid rent and unamortized tenant improvements. Because issues of fact preclude summary judgment on the cancellation claim, we reverse that ruling, but affirm the dismissal of the unpaid rent claim.

Factual and Procedural Background

¶2 The basic factual background is undisputed. The City leased office space in a building owned by Desert Heritage. Although there were multiple leases for different spaces, the lease at the center of this controversy involved space used by the City’s Human Resources Department (“HR lease” or “the lease”). An addendum to the lease included a cancellation clause providing circumstances under which the City could cancel the lease before the end of its term, March 31, 2008. The clause reads:

In the event that the Mayor and Council of the City of Tucson shall not appropriate sufficient funds for the payment of the rent (as set forth by the Lease) in the adopted budget for the fiscal years subsequent to 2000 – 2001, then [the City] shall have the right annually upon the anniversary of its lease term, with 90 days prior written notice to [Desert Heritage], to cancel the lease. In such an event, [the City] will immediately pay to [Desert Heritage] the total sum of any unamortized costs for tenant[’s] improvements to the demised premises.

In December 2005, the Mayor and Council adopted a resolution directing the City Manager to “eliminate funding from the annual City budget for outside rental of office space for the City of Tucson Department of Human Resources for fiscal Year 2006–2007.” One week later, the City notified Desert Heritage that it would exercise the cancellation clause in the lease, effective April 1, 2006.

¶3 Desert Heritage then sued the City, claiming it had breached the lease by failing to comply with the cancellation clause and by violating the covenant of good faith and fair dealing in exercising that clause. It also sought damages for unpaid rent and unamortized tenant improvement costs. The City moved for partial summary judgment, contending that it had complied with the cancellation clause and that it did not violate the covenant of good faith and fair dealing. The trial court granted that motion. * * * *

Compliance with the Cancellation Clause

¶4 Desert Heritage first argues the trial court erred by granting summary judgment against it on its claim that the City breached the lease by failing to properly comply with the cancellation clause. We review the grant of summary judgment de novo and view the facts in the light most favorable to the opposing party. *Liberty Mut. Fire Ins. Co. v. Mandile*, 192 Ariz. 216, 222, 963 P.2d 295, 301 (App. 1997). “[W]e reverse the summary judgment if our review reveals that reasonable inferences concerning material facts could be resolved in favor of the opposing party.” *Id.*

¶5 Our goal in interpreting a contract is to determine the parties’ intent and give effect to the contract as a whole. *Potter v. U.S. Specialty Ins. Co.*, 209 Ariz. 122, ¶ 7, 98 P.3d 557, 559 (App. 2004). We view the language of the contract in the context of the surrounding circumstances. *Id.* We will enforce a valid contract even if the result is harsh. *Freedman v. Cont’l Serv. Corp.*, 127 Ariz. 540, 545, 622 P.2d 487, 492 (App. 1980).

¶6 Desert Heritage contends the cancellation clause requires that the Mayor and Council fail to appropriate funds and asserts the process of cancellation and relocation had

begun before the Mayor and Council were even involved. But the cancellation clause does not require that the idea of cancellation originate with the Mayor and Council. It simply requires that they fail to appropriate funds and allows the City to cancel the lease on an anniversary date so long as it provides Desert Heritage with ninety days' notice. It did provide such notice. The trial court did not err in finding that the City had complied with the express terms of the cancellation clause.

[¶7] * * * *

[¶8] Finally, Desert Heritage contends that the only valid reason for cancellation under the clause is a lack of sufficient funds to pay for the lease. But the cancellation clause does not limit the reasons for cancellation to a lack of funds. Instead, the decision to “appropriate” funds is a discretionary, legislative act. Therefore, this argument also fails.

[¶9] Even assuming the City’s cancellation was “self-serving,” as Desert Heritage argues, the trial court correctly determined that the City properly had complied with the express terms of the cancellation clause. And, therefore, the City was entitled to summary judgment on that portion of the cancellation claim.

Covenant of Good Faith and Fair Dealing

[¶10] Desert Heritage next argues the trial court erred by determining that Desert Heritage had not raised a genuine issue of material fact concerning the City’s alleged breach of the lease’s implied covenant of good faith and fair dealing. Again our review is de novo. *Liberty Mut. Fire Ins. Co.*, 192 Ariz. at 222, 963 P.2d at 301.

[¶11] The covenant of good faith and fair dealing is implied in every contract. *Bike Fashion Corp. v. Kramer*, 202 Ariz. 420, ¶ 13, 46 P.3d 431, 434 (App. 2002). “A party may breach an express covenant of the contract without breaching the implied covenant of good faith and fair dealing.” *Wells Fargo Bank v. Ariz. Laborers, Teamsters & Cement Masons Local No. 395 Pension Trust Fund*, 201 Ariz. 474, ¶ 64, 38 P.3d 12, 29 (2002). “Conversely, because a party may be injured when the other party to a contract manipulates bargaining power to its own advantage, a party may nevertheless breach its duty of good faith without actually breaching an express covenant in the contract.” *Id.*

[¶12] It follows from this that “[i]nstances inevitably arise where one party exercises discretion retained or unexercised under a contract in such a way as to deny the other a reasonably expected benefit of the bargain.” *Bike Fashion Corp.*, 202 Ariz. 420, ¶ 14, 46 P.3d at 435, quoting *Wells Fargo Bank*, 201 Ariz. 474, ¶ 66, 38 P.3d at 30 (alteration in *Bike Fashion Corp.*).

Thus, Arizona law recognizes that a party can breach the implied covenant of good faith and fair dealing both by exercising express discretion in a way inconsistent with a party’s reasonable expectations and by acting in ways not expressly excluded

by the contract's terms but which nevertheless bear adversely on the party's reasonably expected benefits of the bargain.

Id.

[¶13] In *Wells Fargo Bank*, the court quoted Professor Steven J. Burton's explanation of the duty of good faith:

“The good faith performance doctrine may be said to permit the exercise of discretion for any purpose—including ordinary business purposes—reasonably within the contemplation of the parties. A contract thus would be breached by a failure to perform in good faith if a party uses its discretion for a reason outside the contemplated range—a reason beyond the risks assumed by the party claiming a breach.”

201 Ariz. 474, ¶ 66, 38 P.3d at 30, *quoting Sw. Sav. & Loan Ass'n v. SunAmp Sys., Inc.*, 172 Ariz. 553, 558-59, 838 P.2d 1314, 1319-20 (App. 1992) (footnotes omitted in *Sw. Sav. & Loan*), *quoting* Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 Harv. L. Rev. 369, 385-86 (1980). The court further observed:

Burton's recitation fully comports with RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a (1981), which states, “Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party.” Consistent with Burton and the RESTATEMENT, this court has held in a variety of contexts that a contracting party may not exercise a retained contractual power in bad faith. *See Rawlings [v. Apodaca]*, 151 Ariz. 149,] 153-157, 726 P.2d [565,] 569-73 [(1986)] (power to adjust claims in an insurance contract); *Wagenseller [v. Scottsdale Memorial Hosp.]*, 147 Ariz. 370,] 385-86, 710 P.2d [1025,] 1040-41 [(1985)] (power to fire employee at will for a bad cause).

Wells Fargo Bank, 201 Ariz. 474, ¶ 66, 38 P.3d at 30. Whether a party's actions constitute a breach of the covenant of good faith and fair dealing is a question of fact. *See id.* ¶¶ 69-70.

[¶14] Desert Heritage produced evidence of continuous conflict between it and representatives of the City that had been ongoing before the City exercised the cancellation clause. This included evidence that the City had offered to remain at Desert Heritage's building if Desert Heritage dropped its claim for unpaid rent. Desert Heritage also claimed that, when the City was unable to obtain the concessions it wanted concerning the lease during settlement negotiations, the City decided to exercise the cancellation clause. A jury could determine that the City's alleged use of the cancellation clause to force Desert Heritage to make other concessions regarding the lease was ““outside the contemplated range—a reason beyond the risks assumed by the party claiming a breach.”” *Wells Fargo Bank*, 201 Ariz. 474, ¶ 66, 38 P.3d at 30, *quoting Sw. Sav. & Loan*, 172 Ariz. at 558-59, 838 P.2d at 1319-20, *quoting* Burton, *supra*, at 385-86.

[¶15] The City claims that it cancelled the lease to reduce expenses and to increase efficiency. But Desert Heritage produced evidence that the City had another motivation

and therefore has raised a genuine issue of material fact. Furthermore, based on the limited arguments and evidence presented so far, a jury reasonably could conclude that these goals should have been considered by the City before it entered the lease and, accordingly, were outside the contemplated range. Conversely, a jury could conclude these reasons were not outside the contemplated range. Therefore, even if the jury finds that the City was motivated by cost savings and efficiency, an issue of fact exists at this point in time with regard to whether those motivations constitute bad faith. Accordingly, we conclude the trial court erred by granting summary judgment on this portion of the claim.

¶16 The City, however, relies on *Southwest Savings & Loan* for the proposition that “[a]cts in accord with the terms of one’s contract cannot *without more* be equated with bad faith.” *Sw. Sav. & Loan*, 172 Ariz. at 558, 838 P.2d at 1319 (emphasis in *Sw. Sav. & Loan*), quoting *Balfour, Guthrie & Co. v. Gourmet Farms*, 166 Cal. Rptr. 422, 427-28 (Ct. App. 1980). We agree with that statement of the law. But here Desert Heritage produced some evidence from which a reasonable jury could conclude the City had acted in bad faith. If the jury determines that the City acted in bad faith as outlined above, the cancellation was not an act in accord with the terms of the contract, *without more*.

¶17 Because we have concluded an issue of fact exists as to whether the City breached the covenant of good faith and fair dealing by cancelling the lease, we need not address Desert Heritage’s argument that, even if cancellation was proper, the City could not cancel the lease until March 2007. Additionally, Desert Heritage’s claim for unamortized tenant improvements may become moot, and we will not, therefore, address whether the trial court properly dismissed the claim. * * * *

Conclusion

¶25 For the foregoing reasons, * * * we reverse the summary judgment with respect to Desert Heritage’s claim that the City violated the covenant of good faith and fair dealing when it cancelled the lease. We remand the case for proceedings consistent with this decision. * * * *

Questions:

1. Choose a source for the good faith obligation as described and applied by the *Desert Heritage* court: (a) community standards, (b) economic efficiency, (c) agreement, (d) the bargain of the parties. Why?
2. Not all courts have been so functional with their definitions of good faith. The courts have struggled for a long time with what good faith requires. The law has coalesced around something like what the *Desert Heritage* case describes. Consider the following from *Wilson v. Amerada Hess Corp.*, 773 A.2d 1121, 1126-31 (N.J. 2001):

[¶1] A covenant of good faith and fair dealing is implied in every contract in New Jersey. *Sons of Thunder, Inc. v. Borden, Inc.*, 148 N.J. 396, 420, 690 A.2d 575 (1997) (citing numerous cases of this Court holding covenant implied in every contract). That covenant is among the few terms that "[c]ourts have been called upon to supply." E. Allan Farnsworth, *Contracts* § 1.5, at 12-14 (1990).

[¶2] Implied covenants are as effective components of an agreement as those covenants that are express. *Aronsohn v. Mandara*, 98 N.J. 92, 100, 484 A.2d 675 (1984). Although the implied covenant of good faith and fair dealing cannot override an express term in a contract, a party's performance under a contract may breach that implied covenant even though that performance does not violate a pertinent express term. *Sons of Thunder, Inc.*, *supra*, 148 N.J. at 419, 690 A.2d 575. Unlike many other states, in New Jersey "a party to a contract may breach the implied covenant of good faith and fair dealing in performing its obligations even when it exercises an express and unconditional right to terminate." *Id.* at 422, 690 A.2d 575; *see also Bak-A-Lum Corp. v. Alcoa Bldg. Prods., Inc.*, 69 N.J. 123, 129-30, 351 A.2d 349 (1976) (finding that defendant's conduct in terminating contract constituted bad faith although conduct did not violate express terms of written agreement); *cf. Burger King Corp. v. Weaver*, 169 F.3d 1310, 1316 (11th Cir.1999) (finding that under Florida law action for breach of implied covenant of good faith and fair dealing cannot be maintained in absence of breach of express contract provision); *Payne v. McDonald's Corp.*, 957 F. Supp. 749, 758 (D.Md.1997) (determining that under Illinois law covenant of good faith and fair dealing does not provide independent source of duties). Other jurisdictions regard the implied covenant of good faith and fair dealing as merely a guide in the construction of explicit terms in an agreement. *See Payne, supra*, 957 F. Supp. at 758 (citing *Beraha v. Baxter Health Care Corp.*, 956 F.2d 1436, 1443 (7th Cir.1992)).

[¶3] What constitutes good faith performance and fair dealing has been the subject of considerable analysis. For transactions involving merchants and the sale of goods, the Uniform Commercial Code has defined good faith as "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." N.J.S.A. 12A:2-103(1)(b). The Restatement (Second) of Contracts notes that every contract imposes on each party a duty of good faith and fair dealing in its performance and enforcement. Restatement (Second) of Contracts § 205 (1981). A comment to the Restatement states that "[g]ood faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness." Restatement (Second) of Contracts § 205 comment a (1981). In *Sons of Thunder, Inc.*, *supra*, we reaffirmed our earlier formulation:

In every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the

other party to receive the fruits of the contract; which means that in every contract there exists an implied covenant of good faith and fair dealing. [148 N.J. at 421, 690 A.2d 575 (quoting *Palisades Properties, Inc. v. Brunetti*, 44 N.J. 117, 130, 207 A.2d 522 (1965))(citing 5 Williston on Contracts § 670, at 159-60 (3d ed.1961)).]

[¶4] * * * * Here we are confronted with the question of the appropriate force of the implied covenant of good faith and fair dealing in reviewing the actions of a contracting party expressly vested with unilateral discretionary authority over pricing. Stated differently, the task here is to identify in that context the parties' reasonable expectations.

[¶5] In his widely cited law review article, Professor Steven J. Burton discusses the implied covenant of good faith and fair dealing in respect of contracts authorizing one party to have the discretion to make decisions as to quantity, price, time, and other conditional aspects of a contract. Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 Harv. L.Rev. 369 (1980). Professor Burton comments that decisions concerning price that are deferred to the discretion of one of the parties must be made in good faith. *Id.* at 381-82. He explains that "[a] party with discretion may withhold all benefits for good reasons. . . . The fact that a discretion-exercising party causes the dependent party to lose some or all of its anticipated benefit from the contract thus is insufficient to establish a breach of contract by failing to perform in good faith." *Id.* at 384-85. A good faith performance doctrine may be said to permit the exercise of discretion for any purpose—including ordinary business purposes—reasonably within the contemplation of the parties. *Id.* at 385-86. It follows, then, that "[a] contract thus would be breached by a failure to perform in good faith if a party uses its discretion for a reason outside the contemplated range— a reason beyond the risks assumed by the party claiming the breach." *Id.* at 386.

[¶6] Professor Burton's approach respects the express bargain of parties that gave unilateral authority over price to one party alone. That approach also requires that the discretion-exercising party not unilaterally use that authority in a way that intentionally subjects the other party to a risk beyond the normal business risks that the parties could have contemplated at the time of contract formation. In this manner,

[t]he good faith performance doctrine may be said to enhance economic efficiency by reducing the costs of contracting. The costs of exchange include the costs of gathering information with which to choose one's contracting partners, negotiating and drafting contracts, and risk taking with respect to the future. The good faith performance doctrine reduces all three kinds of costs by allowing parties to rely on the law in place of incurring some of these costs.

[*Id.* at 393.]

[¶7] In the same vein, various courts have stated that a party must exercise discretion reasonably and with proper motive when that party is vested with the exercise of discretion under a contract. * * * *

III.

[¶8] The question remaining is whether plaintiffs had a full opportunity to show bad motive on Hess's part before Hess was granted summary judgment. Plaintiffs claim that they were denied information that would provide circumstantial evidence of lack of good faith. Plaintiffs' bad faith claim is that Hess set its DTW prices with the specific intent to impair the ability of the dealers to compete in the gasoline market or, alternatively, to discourage the franchisees from continuing in the business in order to replace them with Hess co-op stations.

[¶9] Plaintiffs moved to compel the production of documents showing the performance, costs, volumes, margins, and profits of the Hess co-op stations and DAP stations in the marketing areas of plaintiffs' stations. They contend that those documents would have shown that Hess knew that based on the necessary operating costs involved with running plaintiffs' stations, plaintiffs could not sustain their businesses on the pricing differential allowed and the resultant decreased sales volume. Plaintiffs contend that that information, in conjunction with information showing that, since the 1980s, Hess stations have changed from being predominantly run by franchisees to predominantly Hess-run, would create a jury question concerning whether Hess acted with an improper motive. Plaintiffs' requested discovery was denied by the trial court. Although deference is generally accorded to the trial court on such matters, see *Connolly v. Burger King Corp.*, 306 N.J. Super. 344, 349, 703 A.2d 941 (App. Div. 1997) (stating that abuse of discretion standard applies to review of decision regarding discovery), in this instance we cannot dismiss the possibility that the information plaintiffs sought would raise a jury question on the issue of breach of the implied covenant. * * * *

[¶10] We part company with the Appellate Division * * * in respect of its conclusion that the further discovery sought by plaintiffs was unlikely to lead to the discovery of relevant evidence on the question of breach by Hess. Here, the contention is that Hess set prices intending to destroy plaintiffs economically. Although that allegation may be difficult to prove, our province is not to decide questions of fact, but only to determine whether sufficient information has been presented to warrant a jury determination. A corollary of that principle is that a plaintiff must have a reasonable opportunity to obtain facts not available to it other than through formal discovery.

Choose a source for the good faith obligation as described and applied by the *Amerada Hess* court: (a) community standards, (b) economic efficiency, (c) agreement, (d) the

bargain of the parties. Why?

3. Does the good faith standard allow sufficient certainty that parties may ex ante be assured of the economic efficiency of their deals?

4. If you had to choose a moral basis for the good faith standard, what would it be?

5. Is the good faith obligation an extension of the cooperation requirement? Vice versa? Are they separate?

Uniform Commercial Code §§ 1-201(b)(20), 1-304

NEUMILLER FARMS, INC. v. Jonah D. CORNETT et al.
Alabama Supreme Court (1979), 368 So.2d 272

SHORES, Justice.

[¶1] Jonah D. Cornett and Ralph Moore, Sellers, were potato farmers in DeKalb County, Alabama. Neumiller Farms, Inc., Buyer, was a corporation engaged in brokering potatoes from the growers to the makers of potato chips. The controversy concerns Buyer's rejection of nine loads of potatoes out of a contract calling for twelve loads. A jury returned a verdict of \$17,500 for Sellers based on a breach of contract. Buyer appealed. We affirm.

[¶2] From the evidence, the jury could have found the following:

[¶3] On March 3, 1976, the parties signed a written contract whereby Sellers agreed to deliver twelve loads of chipping potatoes to Buyer during July and August, 1976, and Buyer agreed to pay \$4.25 per hundredweight. The contract required that the potatoes be United States Grade No. 1 and "chipt [sic] to buyer satisfaction." As the term was used in this contract, a load of potatoes contains 430 hundredweight and is valued at \$1,827.50.

[¶3] Sellers' potato crop yielded twenty to twenty-four loads of potatoes and Buyer accepted three of these loads without objection. At that time, the market price of chipping potatoes was \$4.25 per hundredweight. Shortly thereafter, the market price declined to \$2.00 per hundredweight.

[¶4] When Sellers tendered additional loads of potatoes, Buyer refused acceptance, saying the potatoes would not "chip" satisfactorily. Sellers responded by having samples of their crop tested by an expert from the Cooperative Extension Service of Jackson County, Alabama, who reported that the potatoes were suitable in all respects. After receiving a letter demanding performance of the contract, Buyer agreed to "try one more load." Sellers then tendered a load of potatoes which had been purchased from another

grower, Roy Hartline. Although Buyer's agent had recently purchased potatoes from Hartline at \$2.00 per hundredweight, he claimed dissatisfaction with potatoes from the same fields when tendered by Sellers at \$4.25 per hundredweight. Apparently the jury believed this testimony outweighed statements by Buyer's agents that Sellers' potatoes were diseased and unfit for "chipping."

[¶5] Subsequently, Sellers offered to purchase the remaining nine loads of potatoes from other growers in order to fulfill their contract. Buyer's agent refused this offer, saying ". . . 'I'm not going to accept any more of your potatoes. If you load any more I'll see that they're turned down.' . . . 'I can buy potatoes all day for \$2.00.'" No further efforts were made by Sellers to perform the contract.

[¶6] At the time of Buyer's final refusal, Sellers had between seventeen and twenty-one loads of potatoes unharvested in their fields. Approximately four loads were sold in Chattanooga, Tennessee; Atlanta, Georgia; and local markets in DeKalb County. Sellers' efforts to sell their potato crop to other buyers were hampered by poor market conditions. Considering all of the evidence, the jury could properly have found that Sellers' efforts to sell the potatoes, after Buyer's final refusal to accept delivery, were reasonable and made in good faith.

[¶7] This case presents three questions: 1) Was Buyer's refusal to accept delivery of Sellers' potatoes a breach of contract? 2) If so, what was the proper measure of Sellers' damages? and 3) Was the \$17,500 jury verdict within the amount recoverable by Sellers under the proper measure of damages?

[¶8] § 7-2-703, Code of Alabama 1975 (UCC), specifies an aggrieved seller may recover for a breach of contract "Where the buyer *wrongfully* rejects . . . goods" (Emphasis Added.) We must determine whether there was evidence from which the jury could find that the Buyer acted wrongfully in rejecting delivery of Sellers' potatoes.

[¶9] A buyer may reject delivery of goods if either the goods or the tender of delivery fails to conform to the contract. § 7-2-601, Code of Alabama 1975. In the instant case, Buyer did not claim the tender was inadequate. Rather, Buyer asserted the potatoes failed to conform to the requirements of the contract: i. e., the potatoes would not chip to buyer satisfaction.

[¶10] The law requires such a claim of dissatisfaction to be made in good faith, rather than in an effort to escape a bad bargain. *Shelton v. Shelton*, 238 Ala. 489, 192 So. 55 (1939); *Jones v. Lanier*, 198 Ala. 363, 73 So. 535 (1916); *Electric Lighting Co. v. Elder Bros.*, 115 Ala. 138, 21 So. 983 (1896).

[¶11] Buyer, in the instant case, is a broker who deals in farm products as part of its occupation and, therefore, is a "merchant" with respect to its dealings in such goods. § 7-2-104, Code of Alabama 1975. In testing the good faith of a merchant, § 7-2-103, Code of

Alabama 1975, requires ". . . honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." A claim of dissatisfaction by a merchant-buyer of fungible goods must be evaluated using an objective standard to determine whether the claim is made in good faith. Because there was evidence that the potatoes would "chip" satisfactorily, the jury was not required to accept Buyer's subjective claim to the contrary. A rejection of goods based on a claim of dissatisfaction, which is not made in good faith, is ineffectual and constitutes a breach of contract for which damages are recoverable. * *

[¶12] Suffice it to say that there is evidence in the record from which the jury could reasonably conclude that the Sellers substantially performed their part of the bargain and had incurred substantially all of the expenses incidental to performance on their part. This being so, the jury's verdict of \$17,500 was within those damages recoverable by Sellers as a consequence of Buyer's breach of contract.

AFFIRMED.

TORBERT, C. J., and MADDOX, JONES and BEATTY, JJ., concur.

Question: Did the court use the *Desert Heritage* definition of good faith? The *Amerada Hess* standard? If you were to make explicit what good faith required in this contract that was breached by the Buyer, how would you state it?

Paul REID v. KEY BANK OF SOUTHERN MAINE, INC.
1st Cir. U.S. Ct. App. (1987), 821 F.2d 9

BOWNES, Circuit Judge.

[¶1] Plaintiffs Paul and Mary J. Reid brought a seventeen-count action in United States District Court for the District of Maine against Key Bank of Southern Maine, Inc., defendant. Plaintiffs alleged various federal and state claims resulting from the actions of Depositors Trust Co. of Southern Maine (Depositors), Key Bank's predecessor in interest. The suit grew out of the circumstances surrounding the termination by Depositors of plaintiffs' credit arrangement with it. A jury trial resulted in a verdict for plaintiffs on one of the counts and an award of damages. Both parties have appealed.

I. SUMMARY OF THE FACTS

[¶2] In mid-1975, Paul Reid approached Depositors to obtain financing for the establishment of a painting business. From 1976 through 1979, Depositors granted Reid a series of loans which Reid used for the operation of his business, Pro Paint and Decorating. During this period, Peter H. Traill was the loan officer responsible for Reid's accounts,

Marco F. DeSalle was the president of the bank, and Henry Lawson was, for a time, an assistant vice-president.

[¶3] On March 2, 1979, Reid and Depositors entered into a \$25,000 commercial credit agreement. The agreement was variously explained at trial as a "line of credit" and an "incomplete loan." However defined, it was the largest amount of credit Depositors had yet extended to Reid. Reid sought the credit primarily to finance work he was performing at the Bucksport Housing Project for Nickerson & O'Day, Inc., a general contractor.

[¶4] In mid-May, 1979, Traill telephoned Reid and informed him that Depositors would not grant him any further advances under the March agreement. Reid had thought at the time that this halt of further advances might only be temporary. Defendant claimed that Traill sent Reid a follow-up letter on May 18, 1979, stating that Depositors would no longer honor overdrafts on Reid's accounts and suggesting that Reid restructure his debts with another lender. Reid denied receiving the letter and alleged that it was never, in fact, sent to him.

[¶5] On May 29, 1979, Nickerson & O'Day sent a check to Depositors as payment for Reid's work at the Bucksport Housing Project. The check was for \$6,507.90. It was made out to Depositors and to Pro Paint pursuant to an agreement between Depositors and Reid whereby Reid assigned his accounts receivable to Depositors as security for the March loan. Depositors credited \$2,500 to the account of Pro Paint and applied the remaining \$4,007.90 to offset part of the outstanding balance on Reid's March loan. Reid claimed that Depositors undertook this action without his authorization.

[¶6] Reid claimed that another check was also inappropriately handled by Depositors. He testified that on June 8, 1979, he gave Traill a check for an amount somewhere between eleven and fifteen thousand dollars. Reid contended that this check represented the proceeds for work he performed at Brunswick Naval Air Station. He alleged that Depositors converted the check and used it to offset part of the balance on the March loan. Defendant strongly contested this claim and implied at trial that the check in question existed only in Reid's imagination.

[¶7] On September 20, 1979, Reid received a past-due notice on the March loan. The notice requested payment of \$694.84 in interest and stated that the payment had been due on September 5, 1979. Reid testified that this was the first notice he had received concerning the March loan.

[¶8] On November 5, 1979, Depositors repossessed Reid's personal automobile and one of his vans. Reid discovered one of the vehicles in a lot and attempted to drive it away. He testified that he did not know it had been repossessed and thought it had been stolen. On a complaint by Lawson, Reid was arrested in connection with this incident and was placed for a time in jail.

[¶9] Reid's business collapsed and he lost his four vehicles and his home. On November 7, 1979, Reid filed a Chapter 13 bankruptcy proceeding which was converted to a Chapter 11 proceeding in January, 1980. Mrs. Reid suffered emotional problems and drug dependency. The couple separated for a period of a year and a half.

[¶10] The Reids, who are black, claimed that Depositors acted in bad faith to limit and then terminate their credit. They also claimed that Depositors' actions were motivated by racial prejudice. Defendant claimed that Depositors acted in good faith to secure its financial interests when it learned of Reid's personal difficulties and mismanagement of his business; it denied that its actions were racially motivated.

[¶11] At trial, the district court directed a verdict for defendant on plaintiffs' claims for violations of the Fair Credit Reporting Act and for breach of fiduciary duties. Plaintiffs withdrew their claims for interference with contractual relations and wrongful dishonoring of checks. The jury found for defendant on plaintiffs' claims for violation of the express terms of the credit agreement, racial discrimination, two counts for infliction of emotional distress, and failure to comply with Article 9 of the Uniform Commercial Code. The jury found for plaintiffs on their pendent state claim for breach of the March loan agreement based on violation of an implied covenant of good faith and fair dealing. It awarded plaintiffs \$100,000 in compensatory and \$500,000 in exemplary damages; the exemplary damages award was struck by the court. Both parties have appealed. In Part II, we address defendant's arguments on appeal; in Parts III-VI we address those of plaintiffs.

II. IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING

A. The Existence of the Cause of Action in Maine

[¶12] Plaintiffs' recovery in contract was based on the theory that when Depositors, in May 1979, and thereafter, shut off Reid's credit and took steps to realize upon its collateral, it violated an implied covenant of good faith contained in the March loan agreement between plaintiffs and Depositors. The district court took as self-evident the proposition that Maine contract law required good faith performance. See generally Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 Harv.L.Rev. 369 (1980). The Uniform Commercial Code, as adopted by Maine, states: "Every contract or duty within this Title imposes an obligation of good faith in its performance or enforcement." 4 Me.Rev.Stat. Ann. tit. 11, Sec. 1-203 (1964). That this obligation carries with it a cause of action seems clear from another provision of the Code: "Any right or obligation declared by this Title is enforceable by action unless the provision declaring it specifies a different and limited effect." *Id.* at Sec. 1-106(2). See also Restatement (Second) of Contracts Sec. 205 (1979).

[¶13] We interpret the Maine cases making reference to the general duty of good faith in light of this general acceptance of the principle. The Maine Supreme Judicial Court has explicitly recognized the U.C.C.'s "broad requirements of good faith, commercial

reasonableness and fair dealing." *Schiavi Mobile Homes, Inc. v. Gironda*, 463 A.2d 722, 724-25 (Me.1983) (citing U.C.C. Secs. 1-203, 2-103 & 1-106, Comment 1). In addition, some aspects of the present case concern the handling of Reid's bank accounts with Depositors and would thus be governed by the standard of "good faith" and "ordinary care" under section 4-103 of the U.C.C. See *C-K Enterprises v. Depositors Trust Co.*, 438 A.2d 262, 265 (Me.1981).

[¶14] In *Linscott v. State Farm Mutual Auto Ins. Co.*, 368 A.2d 1161 (Me.1977), the court discussed whether a duty of good faith existed between an insurer and a third-party tort claimant. The court stated that, while such a duty is "implicit" in the contract between an insurer and its insured, the essentially "adversary" relationship between an insurer and a third-party claimant precludes the finding of such an implicit duty in their dealings. Defendant would have us view the court's finding of a good faith duty between the insurer and the insured as exceptional; under defendant's interpretation, an "adversary" relationship, whether contractual or not, would have no good faith requirement.

[¶15] We cannot agree with this reading of *Linscott*. The general principles of modern contract law, as embodied in Maine's Uniform Commercial Code and recognized in *Schiavi*, mandate that we interpret *Linscott* as finding no duty of good faith toward a third-party claimant primarily because of the absence of a contractual relationship. We view the Maine court as implicitly recognizing that contractual relationships of the present nature are governed by a requirement of good faith performance. We do not think that this duty to perform in good faith is altered merely by calling the contractual relationship "adversary."

[¶16] Defendant next argues that a cause of action based on the duty is not generally accepted, even if the principle of good faith performance has been widely acknowledged. Defendant cites several cases finding no such cause of action in their jurisdictions. See, e.g., *Management Assistance, Inc. v. Computer Dimensions, Inc.*, 546 F. Supp. 666 (N.D.Ga.1982), *aff'd*, 747 F.2d 708 (11th Cir.1984). These cases generally cite as their authority *Chandler v. Hunter*, 340 So.2d 818, 821 (Ala.App.1976), for the proposition that no jurisdiction has been found that allows such a cause of action.

[¶17] We reject the applicability of *Chandler* and the cases based on it for two reasons. First, a determination that no such cause of action exists would conflict with the clear meaning of section [1-304] of the U.C.C. * * *. We assume that the Maine courts would adhere to the plain language of th[is provision], as well as to generally accepted modern contract principles. Secondly, the fact that numerous jurisdictions have allowed recovery on theories of breach of good faith refutes the empirical assumption upon which *Chandler* appears to have been based. See, e.g., *K.M.C. Co. v. Irving Trust Co.*, 757 F.2d 752 (6th Cir.1985) (suit under New York law by borrower against lender for arbitrary termination of credit); *Power Motive Corp. v. Mannesmann Demag Corp.*, 617 F. Supp. 1048 (D.Colo.1985) (Ohio law); *Fortune v. National Cash Register Co.*, 373 Mass. 96, 364

N.E.2d 1251 (1977) (Massachusetts law). See also *Atlas Truck Leasing, Inc. v. First NH Banks, Inc.*, 808 F.2d 902 (1st Cir.1987) (interpreting New Hampshire law).*

[¶18] Defendant argues that the "demand" provision of the note establishing the credit agreement precludes a good faith requirement in this case, even if such a requirement is recognized in general. Defendant contends that this exception to the general good faith requirement is mandated by section [1-208 [now 1-309] of the U.C.C., as interpreted by the U.C.C. Comment to the section. Section 1-208 states:

Sec. 1-208. Option to accelerate at will

A term providing that one party or his successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or "when he deems himself insecure" or in words of similar import shall be construed to mean that he shall have power to do so only if he in good faith believes that the prospect of payment or performance is impaired. . . .

The U.C.C. Comment observes:

Obviously this section has no application to demand instruments or obligations whose very nature permits call at any time with or without reason.

[¶19] We turn, therefore, to the documents establishing the loan to see whether they clearly gave Depositors the right to demand payment or terminate the relationship on demand and without cause. The "Secured Interest Note," dated March 2, 1979, states in its opening paragraph:

On Demand, after date, for value received, [Paul Reid d/b/a Pro Paint & Decorating] . . . promise[s] to pay to the order of [Depositors] . . . Twenty-five Thousand and no/100 DOLLARS with interest at 13.75 per cent per annum payable quarterly.

[¶20] This provision appears, at first glance, to be an unambiguous demand clause. It cannot, however, possibly be read literally in the context of the kind of agreement entered into here. Although the note seems to grant Depositors the right to immediate repayment of \$25,000 "on demand," Reid had not yet received that sum of money from the bank. Indeed, he was never to receive the full amount. The "demand" provision thus cannot represent the beginning and end of the inquiry into the time term of the contract.

[¶21] DeSalle, president of Depositors, testified to similar effect at trial, based on his knowledge of banking practices. He said that the "demand" provision in such an agreement is to be interpreted in light of the other conditions in the note and that a bank could not simply terminate the agreement capriciously. He also thought that the absence of a time term in such a note indicated the likelihood that the schedule for repayment of the principal was governed by a verbal agreement between the loan officer and the debtor. In view both

* For an extensive list of jurisdictions recognizing the general obligation of good faith, see the appendix to Burton, *Breach of Contract and the Common Law Duty to Bargain in Good Faith*, 94 Harv.L.Rev. at 404. [Editor: Burton's article is actually entitled ". . . *Duty to Perform in Good Faith*, not *Bargain*.]

of our reading of the document and of DeSalle's testimony about banking practices, we find that the "demand" provision in the note should not be understood as a completely integrated agreement on the time term of the contract. See *Astor v. Boulos Co.*, 451 A.2d 903, 905 (Me.1982); Restatement (Second) of Contracts Sec. 209 (1979).

[¶22] Furthermore, the documents establishing the loan place conditions on the acceleration of payment or termination of the agreement. The "Secured Interest Note" provides for various conditions which would "render" the obligation "payable on demand." The "Security Agreement," also signed March 2, 1979, lists a series of events whose occurrence would signify that Reid would be in "default." The presence of such conditions in both documents indicates that the agreement could not simply be terminated at the whim of the parties; rather, the right of termination or acceleration was subjected to various limitations. The detailed enumeration of events that would "render " the note "payable on demand," or which would put Reid in "default," shows the qualified and relative nature of any "demand" provision. It would be illogical to construe an agreement, providing for repayment or default in the event of certain contingencies, as permitting the creditor, in the absence of the occurrence of those contingencies, to terminate the agreement without any cause whatsoever. Under such a construction, the enumerated conditions would be rendered meaningless. We find, therefore, that the documents establishing the loan defeat neither the legal obligation nor the justifiable expectation of the parties that the contract be performed in good faith.

C. The Standard

[¶23] Defendant challenges the district court's formulation of the test of "good faith" in its instruction to the jury. Defendant claims that the judge instructed the jury that the test for good faith comprises both an objective and a subjective component. Defendant argues that under Maine law an objective standard, such as a "reasonable man" test, may only be applied in cases involving the sales of goods that fall under Article 2 of the U.C.C. Otherwise, defendant claims, any consideration of "good faith" should be limited to its subjective definition in section 1-201(19) [now 1-201(20)] as "honesty in fact."

[¶24] We have examined the judge's original instructions as well as his subsequent clarification of those instructions to determine the precise nature of the test submitted to the jury. In regard to the contract claim, the judge initially formulated two standards. First, he stated that the contract, as a whole, was subject to a "covenant of good faith and fair dealing." Second, with specific reference to the claim that Depositors inappropriately disposed of Reid's collateral, he stated that the bank had a duty to act in a "commercially reasonable manner." In setting the latter standard, he cited Article 9 of the U.C.C. See 5 Me.Rev.Stat. Ann. tit. 11, Secs. 9-501-504. He then twice defined "good faith" in terms indicating a purely subjective standard. He concluded the instruction, however, by reformulating the "good faith" test as including an objective standard of reasonableness.

[¶25] The jury later requested that the judge clarify these instructions. In his new instructions, the judge clearly formulated a subjective standard for good faith:

Now good faith is defined as honesty in fact.

One acts with good faith, in general, when one acts honestly.

Good faith means that one acts without any improper motivation. One acts with the truth and not for some ulterior motive that is unconnected with the substance of the agreement in question when one is acting with good faith.

The judge again referred to the "commercially reasonable" standard only in connection with Article 9 violations.

[¶26] We find, therefore, that the judge ultimately instructed the jury to decide the issue of good faith under the subjective standard. "Honesty in fact" is required under all interpretations of the duty of good faith under section 1-203. Thus, even if we agreed with defendant that the Maine courts would limit an objective standard for good faith to Article 2 cases, we would not find a fatal error in the judge's instructions here.*

D. Sufficiency of Evidence

[¶27] Finally, defendant contends that there was insufficient evidence to support a finding of an absence of good faith, particularly in view of the jury's failure to find that racial discrimination had been an "effective factor" in the termination of Reid's credit at Depositors. We disagree. We affirm the district court's holding that evidence concerning the manner in which Depositors conducted their dealings with Reid was sufficient to support a jury verdict of bad faith and was not based on mere speculation. The standard for defendant's motion for a judgment notwithstanding the verdict was whether the evidence, viewed in the light most favorable to plaintiffs, would lead to the conclusion that no reasonable jury could have found for plaintiffs on the good faith issue. This heavy burden was not met by defendant.

[¶28] We think the jury could have reasonably inferred that Depositors' actions were not taken in good faith. The March, 1979, credit agreement represented the largest amount of credit extended to Reid by the bank, and could be seen as the culmination of an ongoing

* Moreover, we think there are strong indications that such a limitation would not represent the Maine court's future, or even current, thinking on this matter. First, we note that many courts have construed the "good faith" provision of Sec. 1-208 as including an objective component. See, e.g., *K.M.C. Co. v. Irving Trust Co.*, 757 F.2d 752, 760-61 (6th Cir.1985). This construction was supported by the views of Professor Gilmore, one of the drafters of the U.C.C. See 2 G. Gilmore, *Security Interests in Personal Property* Sec. 43.4 at 1197 (1965). See also J. White and R. Summers, *Uniform Commercial Code* 1088 (2d ed.1980) ("The draftsmen apparently intended an objective standard."). Moreover, as many commentators have shown, the difference between so-called "objective" and "subjective" standards is often minimal in practice. See, e.g., J. White and R. Summers at 1088-90. Finally, we note the following pronouncement of the Maine court, broadly paraphrasing Sec. 4-103 of the U.C.C.: "[I]n fact the Uniform Commercial Code imposes a duty of ordinary care and good faith on banks in their dealings with customers." *C-K Enterprises v. Depositors Trust Co.*, 438 A.2d 262, 264 (1981). The use of the sweeping phrase, "in their dealings with customers," arguably extends the protection of "ordinary care" in Maine beyond those bank transactions specifically covered in Article 4.

and mutually beneficial relationship. The jury could have found that by mid-May, when Reid's line of credit was abruptly shut off, he was not in default and his overall position had not changed that significantly, especially as the bank did not first register complaints to him or ask him to alter his conduct in some manner. The bank's president testified that it was customary before cutting off a customer's line of credit to send notices in advance and call the customer to the bank for discussion. This was not done as to Reid, nor was any convincing reason advanced by the bank for not doing so. (The bank, indeed, did not even call as a witness the officer who had dealt directly with Reid and could have best explained why the bank acted as it did.) The jury could have found that in restricting Reid's credit when and as it did the bank was motivated by ulterior considerations, not a good faith concern for its financial security. The jury could have found that the bank decided in bad faith and without notice to terminate the credit relationship as a whole. The jury might have viewed the bank's actions to restrict and terminate Reid's credit to be in bad faith in part because they were taken only a short time after the bank had shown confidence in Reid and had given him grounds to rely on the continuation of the relationship. The jury might have inferred bad faith from these actions of the bank, even if it did not believe that racial prejudice was the effective factor that motivated the bank's bad faith. In sum, the jury could have reasonably found that the bank acted in bad faith in precipitously and without warning halting further advances on which it knew Reid's business depended, in failing to make a sufficient effort to negotiate alternative solutions to any problems it perceived in its relationship with Reid, and in failing to give notice that it intended to terminate the relationship entirely. The evidence concerning these and other aspects of Depositors' actions provided a sufficient basis for a jury finding that the bank's actions were not taken in good faith. * * * *

[¶29] Affirmed. No costs to either party.

Questions:

1. Does the provision of the note stating that payment shall be “on demand” preclude a good faith obligation relevant to this claim?
2. Bonus question: Why doesn't a demand note lack consideration? If the lender can demand the money back immediately, the lender has no obligation
3. Did the trial court here mis-instruct as to the definition of good faith?
4. Was evidence sufficient to show lack of good faith?
5. What does good faith mean in this case?
6. How does the Burton test work out here?

7. Is this court's understanding of good faith based on the same juridical principles as the Burton test or on some other basis?

Uniform Commercial Code § 2-306

Please be forewarned. The court's analyses in the following case and its notes will make your head spin. You can prepare by diagramming carefully subsection (1) of 2-306.

ATLANTIC TRACK & TURNOUT CO. v. PERINI CORP. 1st Cir. U.S. Ct. App. (1993), 989 F.2d 541

TORRUELLA, Circuit Judge.

[¶1] Appellant Atlantic Track & Turnout Company ("Atlantic") brought this breach of contract action pursuant to the Uniform Commercial Code ("Code"), Mass.Gen.L. ch. 106, § 2-101, et seq. (1992). Atlantic alleged that appellee Perini Corporation ("Perini") failed to perform under a contract for the purchase and sale of railroad materials.

[¶2] The court deferred decision on cross motions for summary judgment and ordered a trial limited to two issues: (1) whether the contract was ambiguous; and (2) whether trade usage would supplement the contract terms to enable Atlantic to maintain its action. After Atlantic's proffer, the court entered a judgment on partial findings pursuant to Fed.R.Civ.P. 52(c) in favor of Perini. We affirm that judgment.

BACKGROUND

[¶3] On October 21, 1987, the Massachusetts Bay Transportation Authority ("MBTA") awarded Perini the Eastern Route Track Rehabilitation Project. The project required Perini to rehabilitate a thirteen mile section of double track. The rehabilitation included undercutting the track to replace the ballast, the track's stone foundation, and disposing of any contaminated ballast materials.

[¶4] In the spring of 1988, a sub-contractor tested the ballast under the track and determined that it was all contaminated. Perini received the test results on June 21, 1988 and discussed them with the MBTA on July 17, 1988.

[¶5] In early June, 1988, Perini solicited an offer from Atlantic to buy certain salvage from the project. Between June 28 and 30, 1988, Atlantic issued five purchase orders for "all available" materials. The orders also furnished an estimate of the amount of salvage that would become available.

[¶6] On August 18, 1988, the MBTA directed Perini to suspend undercutting operations until further notice. On September 13, 1988, the MBTA permanently halted all

undercutting due to fiscal constraints. As the elimination of the undercutting reduced the value of the contract by 52%, Perini stopped all work. By October 26, Perini had no physical presence on the project site.

[¶7] On October 31, 1988, Perini proposed an equitable adjustment of the MBTA contract. The proposal entailed an increase in payment for completion of the remaining work under the contract. The MBTA rejected Perini's proposal. Perini and the MBTA thus agreed to terminate the contract.

[¶8] Atlantic knew by August 22, 1988 that all undercutting was suspended and later asked Perini when the remainder of the materials would be available. Perini replied that the MBTA might terminate the project and that Perini had already shipped "all available" salvage in accordance with the purchase orders.* Atlantic sued Perini, claiming that the amount of materials shipped was well below the stated estimates.

LEGAL ANALYSIS

[¶9] Two reasonable interpretations of the contract's plain language exist. On one hand, "all available" implies that Perini satisfied its obligation under the contract by supplying the salvage material that became available; if no material became available to Perini, Perini faced no liability under the contract.† On the other hand, the estimates offered in the purchase orders suggest that Perini had to deliver a quantity nearing those estimates.

[¶10] To convince the court that the latter interpretation represented the true agreement, Atlantic had to overcome two hurdles. First, as the plaintiff, Atlantic had the burden of proving its interpretation by a preponderance of the evidence. Second, any ambiguity in the contract should normally be interpreted against Atlantic, the drafter of the purchase orders. *LFC Lessors, Inc. v. Pacific Sewer Maintenance*, 739 F.2d 4, 7 (1st Cir.1984).

[¶11] Atlantic offered two theories beyond the plain language of the contract supporting its interpretation of the terms. Specifically, Atlantic argued that: (1) trade usage of the term "all available" required Perini to deliver close to the estimated quantity of materials, and (2) § 2-306 of the Code expressly required Perini to provide a quantity approximating its stated estimate. In addition, Atlantic argued that Perini acted in bad faith. Atlantic revives these theories in this appeal, and we address them in turn.

I. Trade Usage

[¶12] The district court ruled that Atlantic's trade usage proffer failed to prove by a preponderance of the evidence that the contract terms embodied Atlantic's proposed

* At this point, Perini had delivered approximately 15% of the materials estimated.

† Of course, the Code requires that Perini attempt to attain the materials in good faith. Mass.Gen.L. ch. 106, § 2-306.

meaning. As this conclusion constitutes a factual finding, Mass.Gen.L. ch. 106, § 1-205(2), we review it only for clear error, *Athas v. United States*, 904 F.2d 79, 80 (1st Cir.1990).

[¶13] Trade usage will supplement the terms of a contract only when the parties know or should know of that usage. Mass.Gen.L. ch. 106, § 1-205(3). In the present case, Atlantic provided no evidence that Perini knew or should have known of Atlantic's interpretation of the term "all available." There was no evidence that Perini engaged in the same trade as Atlantic. Indeed, one Atlantic witness testified that Perini was not a competitor of Atlantic's. Transcript, Non-Jury Trial Proceedings—Day 1, at 106. Therefore, we cannot assume knowledge of Atlantic's trade practices. Furthermore, another Atlantic witness testified that he discussed the terms of the contract with a Perini representative, but never explained the alleged trade usage of "all available." *Id.* at 70. Given the lack of evidence, we cannot find that the district court clearly erred in finding that the proposed trade usage of the term did not supplement the contract terms.

II. Section 2-306

[¶14] Both parties agree that the disputed contract constitutes an output contract governed by § 2-306 of the Code. Section 2-306 of the Code provides in relevant part:

(1) A term which measures the quantity by the output of the seller . . . means such actual output . . . as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate . . . may be tendered or demanded.

In the present case, the contract provided an estimate of the expected output, and Perini tendered only 15% of that quantity. Thus, Atlantic argues that according to § 2-306, Perini violated the contract.

[¶15] While many courts and commentators have discussed the meaning of the "unreasonably disproportionate" clause of § 2-306 as applied to requirements contracts, little has been written on the clause's application to output contracts. We review the former analysis, however, because it provides valuable instruction due to the similarity between these two types of contracts.

[¶16] With respect to requirements contracts, courts differ on the meaning of the "unreasonably disproportionate" clause. Some courts find that "even where one party acts with complete good faith, the section limits the other party's risk in accordance with the reasonable expectations of the parties." *Orange Rockland v. Amerada Hess*, 59 A.D.2d 110, 397 N.Y.S.2d 814, 819 (1977). Most courts and commentators, however, treat cases in which the buyer demands more than the stated estimate differently than cases in which the buyer demands less. See, e.g., *Empire Gas Corp. v. American Bakeries Co.*, 840 F.2d 1333, 1337-38 (7th Cir.1988); *Angelica Uniform Group, Inc. v. Ponderosa Systems, Inc.*, 636 F.2d 232, 232 (8th Cir.1980) (per curiam); *R.A. Weaver and Associates, Inc. v. Asphalt Construction, Inc.*, 587 F.2d 1315, 1322 (D.C.Cir.1978). The courts that employ separate analyses hold that while § 2-306 precludes buyers from demanding a quantity of goods that is unreasonably disproportionate to a stated estimate, it permits "good faith

reductions that are highly disproportionate." R.A. Weaver and Associates, Inc., 587 F.2d at 1315 (emphasis added).*

[¶17] The Seventh Circuit explained the argument well, *Empire Gas Corp.*, 840 F.2d at 1338-40, and we adopt its reasoning. Essentially, the argument is the following. The "unreasonably disproportionate" clause is somewhat redundant in light of the good faith requirement in that section. The clause therefore was likely provided to explain the good faith term. The good faith requirement with respect to disproportionately increased demands needed explanation as certain forms of exploitation in that situation do not clearly constitute bad faith. For example, if the market price of the subject goods rises above the contract price, a buyer in a requirements contract might be tempted to demand more goods than it truly needs in order to resell them for the better market price. The clause eliminates that opportunity. On the other hand, exploitation, beyond bad faith, is not a concern if a buyer demands less than a stated estimate. The seller has the opportunity to sell any excess of the subject goods on the market.

[¶18] Moreover, an obligation to buy approximately a stated estimate of goods would pose a significant burden on buyers as it would force them to make inefficient business judgments, when the point of entering a requirements contract was to engage suppliers without binding themselves to buy more goods than they need. Essentially, a requirements contract represents a risk allocation. "The seller assumes the risk of a change in the buyer's business that makes continuation . . . costly, but the buyer assumes the risk of a less urgent change in [] circumstances." *Id.* at 1340.

[¶19] The same rationale supports different treatment of cases such as the present one, in which the seller in an output contract tenders less than a stated estimate, from cases in which the seller tenders more. See John C. Weistart, *Requirements and Output Contracts: Quantity Variations under the UCC*, 1973 Duke L.J. 599, 638-39 (1973). If a seller saw an opportunity to increase his profits by buying additional goods to resell as output to the buyer, this exploitation might not conclusively establish bad faith. The proviso would forbid such conduct. See *Empire Gas Corp.*, 840 F.2d at 1338. On the other hand, an obligation to sell approximately the stated estimate may force the seller to make inefficient business decisions that the seller did not likely intend when he bargained to keep the contract's quantity provision open.

[¶20] Like the risk allocation in the requirements contract, the output contract allocates to the buyer the risk of a change in the seller's business that makes continuation costly, while the seller assumes the risk of a less urgent change in circumstances. Indeed, pre-

* The comments to the Code shed little light on the issue as they, too, are ambiguous. *Empire Gas Corp. v. American Bakeries Co.*, 840 F.2d at 1338. Comment 3 to § 2-306, for example, provides that an "agreed estimate is to be regarded as a center around which the parties intend the variation to occur," suggesting that the two situations should be treated similarly. Comment 2 to § 2-306, on the other hand supports the view that the two situations should receive different treatment as it provides that "good faith variations from prior requirements are permitted even when the variation may be such as to result in discontinuance." *Id.*

Code Massachusetts courts held that output contracts necessarily contemplated that the level of production would be governed by business judgment. See *Neofotistos v. Harvard Brewing Co.*, 341 Mass. 684, 171 N.E.2d 865, 868 (1961); see also *Weistart*, *supra*, at 639 n. 96. We see no reason for a change in that rationale.

[¶21] Adopting this interpretation of § 2-306, our next, and only inquiry under this section, is whether Perini acted in good faith.

III. Good faith

[¶22] The district court determined that Perini acted in good faith. This was a factual determination that we review only for clear error. *Athas*, 904 F.2d at 80.

[¶23] Atlantic offers two indications of bad faith by Perini. First, Atlantic argues that Perini acted in bad faith by failing to notify Atlantic of the June 21 test results. However, Atlantic offered no evidence that the additional contaminated ballast signified to Perini that the contract would end. Indeed, the record indicates that the additional contamination was good news to Perini because the more contamination that existed, the more money Perini stood to earn under the contract. The MBTA did not notify Perini of its desire to end the contract until August 18 when it suspended the undercutting; Atlantic learned of the suspension just four days later. Thus, the court did not clearly err in finding that Perini acted in good faith with respect to notification.

[¶23] Second, Atlantic argues that Perini acted in bad faith by failing to make a reasonable attempt to complete the MBTA project when the MBTA eliminated the undercutting. Atlantic contends that in its negotiations for an equitable adjustment of the contract, Perini requested an unreasonable increase in the contract price. Thus, Atlantic argues that Perini's attempt to complete the project was in bad faith.

[¶24] Based on the evidence presented, however, this argument fails. For one thing, a contractor may seek an equitable adjustment to the contract when a large quantity of work is eliminated. See *Peter Kiewit Sons' Co. v. United States*, 74 F. Supp. 165, 109 Ct.Cl. 517, 522-23 (1947). Atlantic failed to show that Perini did not make reasonable attempts to negotiate an adjustment. That the MBTA and Perini failed to reach an acceptable agreement does not show that the attempted negotiations were in bad faith.

[¶25] Moreover, a party who ceases performance under an output contract for independent business reasons acts in good faith. *Neofotistos*, 171 N.E.2d at 868. Atlantic offered no evidence that Perini did not agree to end the MBTA contract due to a valid independent business reason. Indeed, Atlantic offered no evidence of any reason why Perini agreed to end the contract. Thus, the district court did not clearly err in its good faith determination.

CONCLUSION

[¶26] Based on the evidence presented, the district court properly granted summary judgment in favor of Perini.

Affirmed.

Questions:

1. Did the contract in this case call for materials in the estimated amount to be shipped?
2. Why all the policy analysis around 2-306? Do good faith and reasonableness mean the same thing? If so, then aren't they redundant in the statute?
3. What purpose does the good faith doctrine serve in this case?
4. In *Simcala, Inc. v. American Coal Trade, Inc.*, 821 So.2d 197 (Al. 2001), Simcala issued a purchase order to American stating it would purchase during 1998 17,500 tons of coal at \$78.50 per ton. The PO also stated, "[T]he above [i.e. 17,500 tons] is an approximate quantity and to be shipped as required." During 1998 Simcala actually purchased only 7,200 tons of coal from ACT, only 41% of the estimate. American sued for breach. The trial court found no evidence of bad faith but held that Simcala had failed to buy the stated estimate, in breach of the contract. On appeal, Simcala argued that the "estimate" clause in the statute should not apply to decreases in quantities ordered in a requirements contract. The Alabama Supreme Court responded:

[¶1] The question presented is one of first impression in Alabama: Whether § 7-2-306(1), Ala. Code 1975, permits a buyer purchasing pursuant to a requirements contract to reduce its requirements to a level unreasonably disproportionate to an agreed-upon estimate so long as it is acting in good faith. The trial court interpreted § 7-2-306(1) to mean that a requirements-contract buyer who has provided the seller an estimate of its requirements may not reduce its requirements to a level unreasonably disproportionate to that estimate, even when it does so in good faith. The trial court concluded that the reduction in this case was unreasonable. The trial court's interpretation of § 7-2-306(1) involves a question of law; it is reviewed de novo by an appellate court, without any presumption of correctness. *Aetna Cas. & Sur. Co. v. Mitchell Bros., Inc.*, 814 So.2d 191, 195 (Ala.2001); *Reed v. Board of Trustees for Alabama State Univ.*, 778 So.2d 791, 793 n. 2 (Ala.2000); *Donnelly v. Doak*, 346 So.2d 414, 416 (Ala.1977).

II. Application of § 7-2-306(1)

[¶2] "Words used in a statute must be given their natural, plain, ordinary, and commonly understood meaning, and where plain language is used a court is bound

to interpret that language to mean exactly what it says.” *IMED Corp. v. Systems Eng’g Assocs. Corp.*, 602 So.2d 344, 346 (Ala.1992), quoted in *Ex parte Fann*, 810 So.2d 631, 633 (Ala.2001). Our primary obligation is to “ascertain and give effect to the intent of the Legislature as that intent is expressed through the language of the statute.” *Ex parte Krothapalli*, 762 So.2d 836, 838 (Ala.2000). Moreover, we must presume “‘that every word, sentence, or provision was intended for some useful purpose, has some force and effect, and that some effect is to be given to each, and also that no superfluous words or provisions were used.’” *Ex parte Children’s Hosp. of Alabama*, 721 So.2d 184 (Ala.1998), quoting *Sheffield v. State*, 708 So.2d 899, 909 (Ala. Crim. App.1997). See also *Elder v. State*, 162 Ala. 41, 45, 50 So. 370, 371 (Ala. 1909) (stating that it is unreasonable to presume that the Legislature intended the words it used to be meaningless).

[¶3] Because this case presents a question of first impression concerning language used in the Uniform Commercial Code, “we look for guidance to the Uniform Commercial Code itself, the official Comments to the Code, the writings of commentators, and the case law of other jurisdictions.” *Massey Ferguson Credit Corp. v. Wells Motor Co.*, 374 So.2d 319, 321 (Ala. 1979). Comment 3 of the official comments to § 7-2-306 states:

“If an estimate of output or requirements is included in the agreement, no quantity unreasonably disproportionate to it may be tendered or demanded. Any minimum or maximum set by the agreement shows a clear limit on the intended elasticity. In similar fashion, the agreed estimate is to be regarded as a center around which the parties intend the variation to occur.”

(Emphasis added.) The use of the word “center” clearly indicates that the drafters intended to prohibit both unreasonably disproportionate increases and decreases from the estimates in a requirements contract. To interpret § 7-2-306(1) to prohibit only unreasonably disproportionate increases, but not decreases, would make the description in official comment 3 of an estimate as a “center around which the parties intend the variation to occur” mere surplus verbiage.

[¶4] Simcala emphasizes official comment 2 in support of its argument that § 7-2-306(1) prohibits only unreasonably disproportionate increases. Comment 2 states:

“Reasonable elasticity in the requirements is expressly envisaged by this section and good faith variations from prior requirements are permitted even when the variation may be such as to result in discontinuance. A shut-down by a requirements buyer for lack of orders might be permissible when a shut-down merely to curtail losses would not. The essential test is whether the party is acting in good faith.”

(Emphasis in Simcala’s brief.) While comment 3 begins with the words, “If an estimate . is included .,” comment 2 does not mention estimates. Comment 2 addresses the general limitation of “good faith,” which applies when there is no agreed-upon estimate. See *Orange & Rockland Utils., Inc. v. Amerada Hess Corp.*,

59 A.D.2d 110, 115, 397 N.Y.S.2d 814, 818-19 (1977). The specificity of comment 3, however, dealing with estimates, displaces the generality of comment 2. Comment 3 therefore applies in the special case, like this one, where the parties have agreed on an estimate. Thus, the drafters' comments to § 7-2-306 support the conclusion that the statute applies both to unreasonably disproportionate increases and decreases from agreed-upon estimates.

[¶5] Some federal courts and other state courts have previously addressed this question. *Brewster of Lynchburg, Inc. v. Dial Corp.*, 33 F.3d 355, 365 (4th Cir. 1994) (predicting direction of Arizona law); *Atlantic Track & Turnout Co. v. Perini Corp.*, 989 F.2d 541, 544-45 (1st Cir.1993) (predicting direction of Massachusetts law on an output contract); *Empire Gas Corp. v. American Bakeries Co.*, 840 F.2d 1333, 1335 (7th Cir.1988) (predicting direction of Illinois law); *R.A. Weaver & Associates, Inc. v. Asphalt Constr., Inc.*, 587 F.2d 1315, 1321-22 (D.C.Cir.1978) (predicting direction of District of Columbia law); *Canusa Corp. v. A & R Lobosco, Inc.*, 986 F. Supp. 723, 729 (E.D.N.Y.1997) (predicting direction of New York law as to an output contract); *Indiana-American Water Co. v. Town of Seelyville*, 698 N.E.2d 1255, 1260 (Ind. App.1998); *Romine, Inc. v. Savannah Steel Co.*, 117 Ga. App. 353, 354, 160 S.E.2d 659, 660-61 (1968). Most of these courts have resolved this issue in favor of the party in Simcala's position, holding that unreasonably disproportionate decreases are permissible so long as the buyer has acted in good faith, but that unreasonably disproportionate increases are impermissible. However, in *Romine v. Savannah Steel Co.*, 117 Ga. App. at 354-55, 160 S.E.2d at 661, the Georgia Court of Appeals interpreted the statute to apply to deviations both above and below the stated estimate. Of course, while these decisions from other jurisdictions may be persuasive, this Court is not bound by federal or other state court decisions construing the laws of other states, even though the law being construed may be identical to Alabama law. *Weems v. Jefferson-Pilot Life Ins., Co.*, 663 So.2d 905, 913 (Ala.1995); *Fox v. Hunt*, 619 So.2d 1364, 1367 (Ala.1993).

[¶6] Several courts that have reached the opposite conclusion have candidly acknowledged that by its plain meaning, the statute prohibits unreasonably disproportionate decreases from estimates. *Brewster*, 33 F.3d at 364 (“Although this statute may appear to prescribe both unreasonably disproportionate increases and reductions in a buyer's requirements, judicial interpretations of this statute provide otherwise.”), *Empire Gas*, 840 F.2d at 1337 (“The proviso does not distinguish between the buyer who demands more than the stated estimate and the buyer who demands less, and therefore if read literally it would forbid a buyer to take (much) less than the stated estimate.”), *R.A. Weaver & Assocs.*, 587 F.2d at 1322 (“The limiting language of Section 2-306(1) accordingly would seem to preclude appellant's reducing its requirements to zero, for zero would appear the quintessential ‘disproportionate amount.’”).

[¶7] Courts interpreting analogous provisions of § 7-2-306(1) to allow unreasonably disproportionate decreases from stated estimates if those decreases are in good faith emphasize concerns over market impact that would flow from following the plain meaning of the statute. See, e.g., *Atlantic Track & Turnout Co.*, 989 F.2d at 545 (“an obligation to buy approximately a stated estimate of goods would pose a significant burden on buyers as it would force them to make inefficient business judgments”); *Empire Gas*, 840 F.2d at 1338 (“If the obligation were not just to refrain from buying a competitor's goods but to buy approximately the stated estimate . . . the contract would be altogether more burdensome to the buyer.”).

[¶8] While other courts may be willing to look beyond the language chosen by their legislatures, we have repeatedly reaffirmed the fundamental principle of statutory construction that, where possible, words must be given their plain meaning. See, e.g., *Ex parte Smallwood*, 511 So.2d 537, 539 (Ala.2001); *Ex parte Krothapalli*, 762 So.2d at 838; *IMED Corp.*, 602 So.2d at 346. The plain language of § 7-2-306(1) admits of only one interpretation—that both unreasonably disproportionate increases and reductions in estimates are forbidden. See *Brewster*, 33 F.3d at 364; *Empire Gas*, 840 F.2d at 1337.

[¶9] As we have repeatedly stated, the function of this Court is “to say what the law is, not what it should be.” *Ex parte Achenbach*, 783 So.2d 4, 7 (Ala.2000), quoting *DeKalb County LP Gas Co. v. Suburban Gas, Inc.*, 729 So.2d 270, 276 (Ala.1998). To hold as Simcala requests we do—that the statute forbids only unreasonably disproportionate increases but not decreases—would require us to presume that the Legislature did not intend the ordinary meaning of the words that it chose to use in its enactment. We conclude that the interpretation supported by the plain meaning of the language of the statute and by the official comments is that § 7-2-306(1) prohibits unreasonably disproportionate decreases made in good faith. If adverse effects on market conditions warrant a different result, it is for the Legislature, not this Court, to amend the statute.

[¶10] The trial court found no evidence that Simcala had acted in bad faith in reducing its requirements, but it found that Simcala had breached the contract because its actual purchases of coal—7,200 tons—were unreasonably disproportionate to its stated estimate—17,500 tons. Simcala does not challenge the finding that its actual purchases from ACT were unreasonably disproportionate to the estimate. Under our construction of § 7-2-306(1), even assuming Simcala's good faith, Simcala breached its requirements contract with ACT by demanding an unreasonably disproportionate reduction from its stated estimate. Thus, further discussion of the trial court's finding that Simcala had acted in good faith is unnecessary.

5. Consider two other arguments: The *Simcala* court seems to think that the word “unreasonably” in the statute meant only “very.” That is one of its meanings. But “unreasonably” might mean “without reason.” That is also a common meaning. The court did not ask what reason justified the decrease but only focused on its magnitude. Perhaps the “good faith” and “estimate” clauses could be harmonized by reading unreasonably this way. In the absence of an estimate, good faith is the standard. If an estimate is made, then reasons must be proved. “Unreasonably” is just a slightly higher standard. There is often a good business reason for having fewer requirements or lower output. Would this reading work?

Also, the statute is written in parallel fashion, output first and requirements second, i.e., “*output* of the seller or the *requirements* of the buyer means such actual *output* or *requirements*.” In the estimate clause, this parallel structure means that “may be tendered” goes with output contracts only; “or demanded” only applies to requirements contracts. Therefore, for output contracts, the estimate clause only prohibits certain kinds of tenders. *Not* tendering is not prohibited by the estimate clause at all. Presumably, only the good faith standard would apply to an output seller who stopped all production. The same would be true of a requirements buyer who did not demand. Not tendering or not demanding is the most extreme form of quantity decrease. If these situations escape the estimate clause entirely, perhaps the estimate clause was not intended to apply to decreases in quantity.

Both of these arguments are grounded in the language of the statute. I wish the *Simcala* court had addressed them.

LARESE v. CREAMLAND DAIRIES, INC.
10th Cir. U.S. Ct. App. (1985), 767 F.2d 716

McKAY, Circuit Judge.

[¶1] The issue in this case is whether a franchisor has an absolute right to refuse to consent to the sale of a franchisee's interest to another prospective franchisee.

[¶2] Plaintiffs entered into a 10-year franchise agreement with defendant, Creamland Dairies, in 1974. The franchise agreement provided that the franchisee "shall not assign, transfer or sublet this franchise, or any of [the] rights under this agreement, without the prior written consent of Area Franchisor [Creamland] and Baskin Robbins, any such unauthorized assignment, transfer or subletting being null and without effect." The plaintiffs attempted to sell their franchise rights in February and August of 1979, but Creamland refused to consent to the sales. Plaintiffs brought suit, alleging that Creamland had interfered with their contractual relations with the prospective buyers by unreasonably withholding its consent. The district court granted summary judgment for the defendant on the ground that the contract gave the defendant an absolute, unqualified right to refuse to consent to proposed sales of the franchise rights. Plaintiffs appeal, claiming that defendant franchisor has a duty to act in good faith and in a commercially reasonable manner when a franchisee seeks to transfer its rights under the franchise agreement.

[¶3] The Colorado courts have never addressed the question of whether a franchisor has a duty to act reasonably in deciding whether to consent to a proposed transfer. The Colorado courts have, however, imposed a reasonableness requirement on consent to transfer clauses in other types of contracts. In *Basnett v. Vista Village Mobile Home Park*, 699 P.2d 1343 (Colo.App.1984), the Colorado appellate court held that a landlord cannot unreasonably refuse to consent to assignment or subleasing by a tenant. While the court indicated that the courts would enforce a provision expressly granting the landlord an absolute right to consent if such a provision was freely negotiated, it refused to find such an absolute right in a provision which provided simply that the landlord must consent to assignment. At 1346 (citing Restatement (2d) of Property Sec. 15.2(2) (1977)). The question before us, therefore, is whether the Colorado courts would impose a similar requirement of reasonableness on restraint on alienation clauses in franchise agreements.

[¶4] Counsel for both parties have argued that the franchisor-franchisee relationship is a special one which is not directly analogous to that of a landlord and tenant. As the Supreme Court of Pennsylvania has noted, "[u]nlike a tenant pursuing his own interests while occupying a landlord's property, a franchisee . . . builds the good will of both his own business and [the franchisor]." *Atlantic Richfield v. Razumic*, 480 Pa. 366, 390 A.2d 736, 742 (1978). This aspect of the relationship has led a number of courts to hold that the franchise relationship imposes a duty upon franchisors not to act unreasonably or arbitrarily in terminating the franchise. See, e.g., *Atlantic Richfield*, 390 A.2d at 742; *Arnott v. American Oil Co.*, 609 F.2d 873 (8th Cir.1979), cert. denied, 446 U.S. 918, 100 S.Ct. 1852, 64 L.Ed.2d 272 (1980); *Shell Oil Co. v. Marinello*, 63 N.J. 402, 307 A.2d 598 (1973). As did these courts, we find that the franchisor-franchisee relationship is one which requires the parties to deal with one another in good faith and in a commercially reasonable manner. See *Arnott*, 609 F.2d at 881 (finding fiduciary duty inherent in franchise relationship); *Atlantic Richfield*, 390 A.2d at 742 (basing decision that franchisor cannot arbitrarily terminate relationship on franchisor's "obligation to deal with its franchisees in good faith and in a commercially reasonable manner").

[¶5] Defendants argue that the franchise assignment situation differs from the franchise termination situation in that the franchisor must work with the person to whom the franchise is assigned. To impose a duty of reasonableness, they argue, would violate the rule of *United States v. Colgate & Co.*, 250 U.S. 300, 307, 39 S.Ct. 465, 468, 63 L.Ed. 992 (1919), that a manufacturer engaged in private business has the right "freely to exercise his own independent discretion as to parties with whom he will deal." This right, however, must be balanced against the rights of the franchisees. As is true in the termination cases, the franchisee has invested time and money into the franchise and, in doing so, has created benefits for the franchisor. We do not find it an excessive infringement of the franchisor's rights to require that the franchisor act reasonably when the franchisee has decided that it wants out of the relationship. The franchisee should not be forced to choose between losing its investment or remaining in the relationship unwillingly when it has provided a reasonable alternative franchisee.

[¶6] We do not hold that a provision which expressly grants to the franchisor an absolute right to refuse to consent is unenforceable when such an agreement was freely negotiated. We do not believe the Colorado courts would find such an absolute right, however, in a provision such as the one involved in this case which provides simply that the franchisee must obtain franchisor consent prior to transfer. See *Vista Village*, at 1346. Rather, the franchisor must bargain for a provision expressly granting the right to withhold consent unreasonably, to insure that the franchisee is put on notice. Since, in this case, the contracts stated only that consent must be obtained, Creamland did not have the right to withhold consent unreasonably.

[¶7] Reversed and remanded for further proceedings consistent with this opinion.

Questions:

1. What is the source of the good faith obligation here?
2. Suppose you are the franchisor in this case. Why do you want to control who owns the franchise?
3. What kind of franchisee would pass in any event?
4. Why did the parties provide for approval of an assignment rather than a clause with greater specificity?

D. Express Conditions

PREFERRED MORTGAGE BROKERS, INC. v. Hervin BYFIELD
Supreme Ct., App. Div., 2d Dept. (2001), 723 N.Y.S.2d 230

[¶1] On November 3, 1997, the defendants retained the plaintiff mortgage broker to assist them in securing financing to purchase a house. The parties' contract required the defendants to pay the plaintiff a fee "directly upon [the] signed acceptance of a commitment." Although the plaintiff alleges that it earned its fee by obtaining a mortgage loan commitment on the defendants' behalf, it is undisputed that the defendants never signed any document accepting the commitment, and did not close on the proposed loan. When the defendants refused to pay the plaintiff a fee, the plaintiff commenced this action seeking damages for breach of contract.

[¶2] The defendants contend that the Supreme Court erred in granting the plaintiff's motion for summary judgment because their signed acceptance of a commitment was a condition precedent to their obligation to pay the plaintiff a broker's fee. We agree. A condition precedent is "an act or event * * * which, unless the condition is excused, must occur before a duty to perform a promise in the agreement arises" (*Oppenheimer & Co. v*

Oppenheim, Appel, Dixon & Co., 86 N.Y.2d 685, 690; Calamari and Perillo, Contracts § 11-2, at 438 [3d ed]). Express conditions precedent, which are those agreed to and imposed by the parties themselves, "must be literally performed" (Oppenheimer & Co. v Oppenheim, Appel, Dixon & Co., supra, at 690). Since the record reveals that the defendants never accepted the loan commitment in writing, the express condition precedent contained in the contract was not satisfied, and the defendants were not obligated to pay a broker's fee (see, Oppenheimer & Co. v Oppenheim, Appel, Dixon & Co., supra; Bradenton Realty Corp. v United Artists Prop. I Corp., 264 A.D.2d 405; Stanton v Power, 254 A.D.2d 153). Therefore, the Supreme Court erred in granting summary judgment to the plaintiff.

[¶3] Furthermore, although the defendants did not cross-move for summary judgment, this Court is authorized by CPLR 3212 (b) to search the record and grant summary judgment to a nonmoving party (see, Dunham v Hilco Constr. Co., 89 N.Y.2d 425; Bartley v Accu-Glo Elec. Corp., 272 A.D.2d 352). Accordingly, summary judgment is granted to the defendants dismissing the complaint.

Questions:

1. What's the difference between the legal effect of the condition in this case and that of the condition in *Luther Williams, Inc.*?
2. Why wasn't the defendants' failure to sign the commitment a failure to cooperate or a breach of the duty of good faith?
2. Please consider the facts of *Dove v. Rose Acre Farms, Inc.*, 434 N.E.2d 931 (Ind. App. 1982):

[¶1] The evidence most favorable to support the judgment and the facts found specially by the trial court are as follows. Dove had been employed by Rose Acre Farms, operated by David Rust (Rust), its president and principal owner, in the summers and other times from 1972 to 1979. The business of Rose Acre was the production of eggs, and, stocked with 4,000,000 hens and staffed with 300 employees, it produced approximately 256,000 dozen eggs per day. Rust had instituted and maintained extensive bonus programs, some of which were for one day only, or one event or activity only. For example, one bonus was the white car bonus; if an employee would buy a new white car, keep it clean and undamaged, place a Rose Acre sign on it, commit no tardiness or absenteeism, and attend one management meeting per month, Rose Acre would pay \$100 per month for 36 months as a bonus above and beyond the employee's regular salary, to apply on payments. Any slight violation, such as being a minute late for work, driving a dirty or damaged car, or missing work for any cause, would work a forfeiture of the bonus. Other bonuses consisted of egg production bonuses, deed conversion bonuses, house management bonuses, and a silver feather bonus. This last bonus program required the participant to wear a silver feather, and a system of rewards and penalties existed for employees who participated. While the conditions of the

bonuses varied, one condition existed in all bonus programs: during the period of the bonus, the employee must not be tardy for even a minute, and must not miss work any day for any cause whatever, even illness. If the employee missed any days during the week, he was sometimes permitted to make them up on Saturday and/or Sunday. Any missed work not made up within the same week worked a forfeiture of the bonus. These rules were explained to the employees and were stated in a written policy. The bonus programs were voluntary, and all the employees did not choose to participate in them. When a bonus was offered a card was issued to the participant stating his name and the terms and amount of the bonus. Upon completion of the required tasks, the card was attached to the pay sheet, and the bonus was added to the paycheck. Rust was strict about tardiness and absenteeism, whether an employee was on a bonus program or not. If an employee was tardy, his pay would be docked to the minimum wage, or he would be sent home and lose an entire day. A minute's tardiness would also deprive the employee of a day for purposes of seniority. As was stated in the evidence, bonuses were given for the "extra mile" or actions "above and beyond the call of duty." The purpose of the bonus programs and penalties was to discourage absenteeism and tardiness, and to promote motivation and dependability.

[¶2] In June 1979, Rust called in Dove and other construction crew leaders and offered a bonus of \$6,000 each if certain detailed construction work was completed in 12 weeks. As Dove conceded in his own testimony, the bonus card indicated that in addition to completing the work, he would be required to work at least five full days a week for 12 weeks to qualify for the bonus. On the same day Dove's bonus agreement, by mutual consent, was amended to ten weeks with a bonus of \$5,000 to enable him to return to law school by September 1. Dove testified that there was no ambiguity in the agreement, and he understood that to qualify for the bonus he would have to work ten weeks, five days a week, commencing at starting time and quitting only at quitting time. Dove testified that he was aware of the provisions concerning absenteeism and tardiness as they affected bonuses, and that if he missed any work, for any reason, including illness, he would forfeit the bonus. The evidence disclosed that no exception had ever been made except as may have occurred by clerical error or inadvertence.

[¶3] In the tenth week Dove came down with strep throat. On Thursday of that week he reported to work with a temperature of 104°, and told Rust that he was unable to work. Rust told him, in effect, that if he went home, he would forfeit the bonus. Rust offered him the opportunity to stay there and lay on a couch, or make up his lost days on Saturday and/or Sunday. Rust told him he could sleep and still qualify for the bonus. Dove left to seek medical treatment and missed two days in the tenth week of the bonus program.

[¶4] Rust refused Dove the bonus based solely upon his missing the two days of work. While there was some question of whether the construction job was finished,

Rust does not seem to have made that issue the basis of his refusal. Bonuses to other crew leaders were paid. The trial court denied Dove's recovery and, in the conclusions of law, stated that Dove had not shown that all of the conditions of the bonus contract had been met. Specifically, Dove failed to work five full days a week for ten weeks.

Dove appealed. Can you think of any arguments (legal, moral, philosophical, or economic) in his favor?

OPPENHEIMER & CO., INC. v. OPPENHEIM, APPEL, DIXON & CO.
N.Y. (1995), 636 N.Y.S.2d 734

CIPARICK, J.

[¶1] The parties entered into a Letter Agreement setting forth certain conditions precedent to the formation and existence of a sublease between them. The agreement provided that there would be no sublease between the parties "unless and until" plaintiff delivered to defendant the prime landlord's written consent to certain "tenant work" on or before a specified deadline. If this condition did not occur, the sublease was to be deemed "null and void." Plaintiff provided only oral notice on the specified date. The issue presented is whether the doctrine of substantial performance applies to the facts of this case. We conclude it does not for the reasons that follow.

I.

[¶2] In 1986, plaintiff Oppenheimer & Co. moved to the World Financial Center in Manhattan, a building constructed by Olympia & York Company (O & Y). At the time of its move, plaintiff had three years remaining on its existing lease for the 33rd floor of the building known as One New York Plaza. As an incentive to induce plaintiff's move, O & Y agreed to make the rental payments due under plaintiff's rental agreement in the event plaintiff was unable to sublease its prior space in One New York Plaza.

[¶3] In December 1986, the parties to this action entered into a conditional Letter Agreement to sublease the 33rd floor. Defendant already leased space on the 29th floor of One New York Plaza and was seeking to expand its operations. The proposed sublease between the parties was attached to the Letter Agreement. The Letter Agreement provided that the proposed sublease would be executed only upon the satisfaction of certain conditions. Pursuant to paragraph 1(a) of the agreement, plaintiff was required to obtain "the Prime Landlord's written notice of confirmation, substantially to the effect that [defendant] is a subtenant of the Premises reasonably acceptable to Prime Landlord." If such written notice of confirmation were not obtained "on or before December 30, 1986, then this letter agreement and the Sublease * * * shall be deemed null and void and of no further force and effect and neither party shall have any rights against nor obligations to the other."

[¶4] Assuming satisfaction of the condition set forth in paragraph 1(a), defendant was required to submit to plaintiff, on or before January 2, 1987, its plans for "tenant work" involving construction of a telephone communication linkage system between the 29th and 33rd floors. Paragraph 4(c) of the Letter Agreement then obligated plaintiff to obtain the prime landlord's "written consent" to the proposed "tenant work" and deliver such consent to defendant on or before January 30, 1987. Furthermore, if defendant had not received the prime landlord's written consent by the agreed date, both the agreement and the sublease were to be deemed "null and void and of no further force and effect," and neither party was to have "any rights against nor obligations to the other." Paragraph 4(d) additionally provided that, notwithstanding satisfaction of the condition set forth in paragraph 1(a), the parties "agree not to execute and exchange the Sublease unless and until * * * the conditions set forth in paragraph (c) above are timely satisfied."

[¶5] The parties extended the Letter Agreement's deadlines in writing and plaintiff timely satisfied the first condition set forth in paragraph 1(a) pursuant to the modified deadline. However, plaintiff never delivered the prime landlord's written consent to the proposed tenant work on or before the modified final deadline of February 25, 1987. Rather, plaintiff's attorney telephoned defendant's attorney on February 25 and informed defendant that the prime landlord's consent had been secured. On February 26, defendant, through its attorney, informed plaintiff's attorney that the Letter Agreement and sublease were invalid for failure to timely deliver the prime landlord's written consent and that it would not agree to an extension of the deadline. The document embodying the prime landlord's written consent was eventually received by plaintiff on March 20, 1987, 23 days after expiration of paragraph 4(c)'s modified final deadline.

[¶6] Plaintiff commenced this action for breach of contract, asserting that defendant waived and/or was estopped by virtue of its conduct^{*} from insisting on physical delivery of the prime landlord's written consent by the February 25 deadline. Plaintiff further alleged in its complaint that it had substantially performed the conditions set forth in the Letter Agreement.

[¶7] At the outset of trial, the court issued an order in limine barring any reference to substantial performance of the terms of the Letter Agreement. Nonetheless, during the course of trial, the court permitted the jury to consider the theory of substantial performance, and additionally charged the jury concerning substantial performance. Special interrogatories were submitted. The jury found that defendant had properly complied with the terms of the Letter Agreement, and answered in the negative the questions whether defendant failed to perform its obligations under the Letter Agreement concerning submission of plans for tenant work, whether defendant by its conduct waived

^{*} Plaintiff argued that it could have met the deadline, but failed to do so only because defendant, acting in bad faith, induced plaintiff into delaying delivery of the landlord's consent. Plaintiff asserted that the parties had previously extended the agreement's deadlines as a matter of course.

the February 25 deadline for delivery by plaintiff of the landlord's written consent to tenant work, and whether defendant by its conduct was equitably estopped from requiring plaintiff's strict adherence to the February 25 deadline. Nonetheless, the jury answered in the affirmative the question, "Did plaintiff substantially perform the conditions set forth in the Letter Agreement?," and awarded plaintiff damages of \$1.2 million.

[¶8] Defendant moved for judgment notwithstanding the verdict. Supreme Court granted the motion, ruling as a matter of law that "the doctrine of substantial performance has no application to this dispute, where the Letter Agreement is free of all ambiguity in setting the deadline that plaintiff concededly did not honor." The Appellate Division reversed the judgment on the law and facts, and reinstated the jury verdict. The court concluded that the question of substantial compliance was properly submitted to the jury and that the verdict should be reinstated because plaintiff's failure to deliver the prime landlord's written consent was inconsequential.

[¶9] This Court granted defendant's motion for leave to appeal and we now reverse.

II.

[¶10] Defendant argues that no sublease or contractual relationship ever arose here because plaintiff failed to satisfy the condition set forth in paragraph 4(c) of the Letter Agreement. Defendant contends that the doctrine of substantial performance is not applicable to excuse plaintiff's failure to deliver the prime landlord's written consent to defendant on or before the date specified in the Letter Agreement and that the Appellate Division erred in holding to the contrary. Before addressing defendant's arguments and the decision of the court below, an understanding of certain relevant principles is helpful.

[¶11] A condition precedent is "an act or event, other than a lapse of time, which, unless the condition is excused, must occur before a duty to perform a promise in the agreement arises" (Calamari and Perillo, Contracts § 11-2, at 438; see Restatement [Second] of Contracts § 224; see also *Merrit Hill Vineyards v Windy Hgts. Vineyard*, 61 NY2d 106, 112-113). Most conditions precedent describe acts or events which must occur before a party is obliged to perform a promise made pursuant to an existing contract, a situation to be distinguished conceptually from a condition precedent to the formation or existence of the contract itself (see *M.K. Metals v Container Recovery Corp.*, 645 F2d 583). In the latter situation, no contract arises "unless and until the condition occurs" (Calamari and Perillo, Contracts § 11-5, at 440).

[¶12] Conditions can be express or implied. Express conditions are those agreed to and imposed by the parties themselves. Implied or constructive conditions are those "imposed by law to do justice" (Calamari and Perillo, Contracts § 11-8, at 444). Express conditions must be literally performed, whereas constructive conditions, which ordinarily arise from language of promise, are subject to the precept that substantial compliance is sufficient. The importance of the distinction has been explained by Professor Williston:

Since an express condition * * * depends for its validity on the manifested intention of the parties, it has the same sanctity as the promise itself. Though the court may regret the harshness of such a condition, as it may regret the harshness of a promise, it must, nevertheless, generally enforce the will of the parties unless to do so will violate public policy. Where, however, the law itself has imposed the condition, in absence of or irrespective of the manifested intention of the parties, it can deal with its creation as it pleases, shaping the boundaries of the constructive condition in such a way as to do justice and avoid hardship. (5 Williston on Contracts § 669, at 154 [3d ed].)

In determining whether a particular agreement makes an event a condition, courts will interpret doubtful language as embodying a promise or constructive condition rather than an express condition. This interpretive preference is especially strong when a finding of express condition would increase the risk of forfeiture by the obligee (see Restatement [Second] of Contracts § 227[1]).

[¶13] Interpretation as a means of reducing the risk of forfeiture cannot be employed if "the occurrence of the event as a condition is expressed in unmistakable language" (Restatement [Second] of Contracts § 229 comm b, at 185; see § 227, comm b [where language is clear, "[t]he policy favoring freedom of contract requires that, within broad limits, the agreement of the parties should be honored even though forfeiture results"]). Nonetheless, the nonoccurrence of the condition may yet be excused by waiver, breach or forfeiture. The Restatement posits that "[t]o the extent that the non-occurrence of a condition would cause disproportionate forfeiture, a court may excuse the non-occurrence of that condition unless its occurrence was a material part of the agreed exchange" (Restatement [Second] of Contracts § 229).

[¶14] Turning to the case at bar, it is undisputed that the critical language of paragraph 4(c) of the Letter Agreement unambiguously establishes an express condition precedent rather than a promise, as the parties employed the unmistakable language of condition ("if," "unless and until"). There is no doubt of the parties' intent and no occasion for interpreting the terms of the Letter Agreement other than as written.

[¶15] Furthermore, plaintiff has never argued, and does not now contend, that the nonoccurrence of the condition set forth in paragraph 4(c) should be excused on the ground of forfeiture.* Rather, plaintiff's primary argument from the inception of this litigation has been that defendant waived or was equitably estopped from invoking paragraph 4(c). Plaintiff argued secondarily that it substantially complied with the express condition of delivery of written notice on or before February 25th in that it gave defendant oral notice of consent on the 25th.

* The Restatement defines the term "forfeiture" as "the denial of compensation that results when the obligee loses [its] right to the agreed exchange after [it] has relied substantially, as by preparation or performance on the expectation of that exchange" (section 229 comm b).

[¶16] Contrary to the decision of the court below, we perceive no justifiable basis for applying the doctrine of substantial performance to the facts of this case.

[¶17] The flexible concept of substantial compliance "stands in sharp contrast to the requirement of strict compliance that protects a party that has taken the precaution of making its duty expressly conditional" (Farnsworth on Contracts § 8.12, at 415). If the parties "have made an event a condition of their agreement, there is no mitigating standard of materiality or substantiality applicable to the non-occurrence of that event" (Restatement [Second] of Contracts § 237 comm d, at 220). Substantial performance in this context is not sufficient, "and if relief is to be had under the contract, it must be through excuse of the non-occurrence of the condition to avoid forfeiture" (id.; see *Brown- Marx Associates, Ltd. v Emigrant Savings Bank*, 703 F2d 1361, 1367- 1368 [11th Cir]; see also Childres, *Conditions in the Law of Contracts*, 45 NYU L Rev 33, 35]).

[¶18] Here, it is undisputed that plaintiff has not suffered a forfeiture or conferred a benefit upon defendant. Plaintiff alludes to a \$1 million licensing fee it allegedly paid to the prime landlord for the purpose of securing the latter's consent to the subleasing of the premises. At no point, however, does plaintiff claim that this sum was forfeited or that it was expended for the purpose of accomplishing the sublease with defendant. It is further undisputed that O & Y, as an inducement to effect plaintiff's move to the World Financial Center, promised to indemnify plaintiff for damages resulting from failure to sublease the 33rd floor of One New York Plaza. Consequently, because the critical concern of forfeiture or unjust enrichment is simply not present in this case, we are not presented with an occasion to consider whether the doctrine of substantial performance is applicable, that is, whether the courts should intervene to excuse the nonoccurrence of a condition precedent to the formation of a contract.

[¶19] The essence of the Appellate Division's holding is that the substantial performance doctrine is universally applicable to all categories of breach of contract, including the nonoccurrence of an express condition precedent. However, as discussed, substantial performance is ordinarily not applicable to excuse the nonoccurrence of an express condition precedent.

[¶20] Our precedents are consistent with this general principle. In *Maxton Bldrs. v Lo Galbo* (68 NY2d 373) the defendants contracted on August 3 to buy a house, but included in the contract the condition that if real estate taxes were found to be above \$3,500 they would have the right to cancel the contract upon written notice to the seller within three days. On August 4 the defendants learned that real estate taxes would indeed exceed \$3,500. The buyers' attorney called the seller's attorney and notified him that the defendants were exercising their option to cancel. A certified letter was sent notifying the seller's attorney of that decision on August 5 but was not received by the seller's attorney on August 9. We held the cancellation ineffective and rejected defendants' argument that reasonable notice was all that was required, stating: "It is settled * * * that when a contract requires that written notice be given within a specified time, the notice is ineffective unless the

writing is actually received within the time prescribed" (id. at 378). We so held despite the fact that timely oral notice was given and the contract did not provide that time was of the essence. * * * *

[¶21] Plaintiff's reliance on the well-known case of *Jacob & Youngs v Kent* (supra) is misplaced. There, a contractor built a summer residence and the buyer refused to pay the remaining balance of the contract price on the ground that the contractor used a different type of pipe than was specified in the contract. The buyer sought to enforce the contract as written. This would have involved the demolition of large parts of the structure at great expense and loss to the seller. This Court, in an opinion by then-Judge Cardozo, ruled for the contractor on the ground that "an omission, both trivial and innocent, will sometimes be atoned for by allowance of the resulting damage and will not always be the breach of a condition to be followed by a forfeiture" (230 NY, at 241). But Judge Cardozo was careful to note that the situation would be different in the case of an express condition:

This is not to say that the parties are not free by apt and certain words to effectuate a purpose that performance of every term shall be a condition of recovery. That question is not here. This is merely to say that the law will be slow to impute the purpose, in the silence of the parties, where the significance of the default is grievously out of proportion to the oppression of the forfeiture (id. at 243-244).

The quoted language contradicts the Appellate Division's proposition that the substantial performance doctrine applies universally, including when the language of the agreement leaves no doubt that an express condition precedent was intended (see 205 AD2d, at 414). More importantly, *Jacob & Youngs* lacks determinative significance here on the additional ground that plaintiff conferred no benefit upon defendant. The avoidance-of- forfeiture rationale which engendered the rule of *Jacob & Youngs* is simply not present here, and the case therefore "should not be extended by analogy where the reason for the rule fails" (*Van Iderstine Co. v Banet Lumber Co.*, 242 NY 425, 434). * * * *

III

[¶22] In sum, the Letter Agreement provides in the clearest language that the parties did not intend to form a contract "unless and until" defendant received written notice of the prime landlord's consent on or before February 25, 1987. Defendant would lease the 33rd floor from plaintiff only on the condition that the landlord consent in writing to a telephone communication linkage system between the 29th and 33rd floors and to defendant's plans for construction effectuating that linkage. This matter was sufficiently important to defendant that it would not enter into the sublease "unless and until" the condition was satisfied. Inasmuch as we are not dealing here with a situation where plaintiff stands to suffer some forfeiture or undue hardship, we perceive no justification for engaging in a "materiality-of-the- nonoccurrence" analysis. To do so would simply frustrate the clearly expressed intention of the parties. Freedom of contract prevails in an arm's length transaction between sophisticated parties such as these, and in the absence of countervailing public policy concerns there is no reason to relieve them of the

consequences of their bargain. If they are dissatisfied with the consequences of their agreement, "the time to say so [was] at the bargaining table" (Maxton, *supra*, at 382).

[¶23] Finally, the issue of substantial performance was not for the jury to resolve in this case. A determination whether there has been substantial performance is to be answered, "if the inferences are certain, by the judges of the law" (Jacob & Youngs v Kent, 230 NY 239, 243).

[¶24] Accordingly, the order of the Appellate Division should be reversed, with costs, and the complaint dismissed.

Aside—Waiver

R. CONRAD MOORE & ASSOCS., INC. v. LERMA
Tex. Ct. App. (1997), 946 S.W.2d 90

OPINION

LARSEN, Justice.

* * * * FACTS

[¶1] On January 30, 1990, the Lermas (Appellees) and R. Conrad Moore & Associates, Inc. (Appellant) entered into an earnest money contract for the purchase of two lots at 1900 Gus Moran in El Paso. The Lermas tendered a check to Moore for \$13,500 as part of the earnest money contract. The sale of the lots was contingent upon the Lermas using Moore as a builder. On April 16, 1990, the Lermas and Moore incorporated the previous contract into a new home residential earnest money contract. This contract provided for the construction of a custom home on the lots for a total price, including the lots, of \$180,000. The new contract called for an additional payment of \$6,500 earnest money, due upon the Lermas' approval of the house plan. Paragraph 4 of the contract required the following:

FINANCING CONDITIONS: This contract is subject to approval for Buyer of a conventional (type of loan) loan (the Loan) to be evidenced by a promissory note (the Note) in the amount of \$ 80,000. Buyer shall apply for the Loan within 15 days from the effective date of this contract and shall make every reasonable effort to obtain approval from Competitive Mortgage Co., as lender, or any lender that will make the Loan. If the Loan cannot be approved within 60 days from the effective date of this contract, this contract shall terminate and the Earnest Money shall be refunded to Buyer without delay. [Emphasis added.]

[¶2] In addition to the standard provision of the preprinted contract, special handwritten provisions were included under Paragraph 11:

- 1) Seller give One Year (1) Builders Warranty and 10-Year H.O.W. warranty

- 2) On Lot held more than 60 days, Earnest Money is non-refundable.
- 3) Lot purchase contract dated January 30, 1990 is hereby transferred to this Home construction contract.
- 4) Balance of Down Payment to be made at time of sale of properties located at 1400 Bodega and 3509 Breckenridge. [Emphasis added.]

[¶3] Construction on the house began in December 1990, and was completed in the summer of 1991. The Lermas were ultimately denied credit and were unable to close on the house. In September 1991, after demanding the return of their earnest money, they initiated this suit in November 1992. After trial to a jury, the Lermas were awarded \$20,000 in damages. The jury found that Moore breached the contract by failing to return the Lermas' earnest money upon the Lermas' failure to get loan approval within the 60 days contemplated by Paragraph 4 of the contract. Moore appeals.

STANDARD OF REVIEW: LEGAL AND FACTUAL SUFFICIENCY

[¶4] Moore asserts in its first six points of error that the evidence was legally or factual insufficient to support the jury's findings.

[¶5] In reviewing a "no evidence" or legal sufficiency claim, we examine only the evidence favorable to the verdict and disregard all evidence to the contrary. * * * *

[¶6] In reviewing a "matter of law" challenge, we first examine the record to see if any evidence supports the finding, ignoring all evidence to the contrary. If no evidence supports the finding, we then determine whether the evidence conclusively establishes its converse. If so, we must reverse. * * * *

Loan Approval

[¶7] In its first point of error, Moore asserts the evidence is legally and factually insufficient to support the jury finding that the Lermas failed to get loan approval for the purchase of the home. After a diligent search of the record, we have been unable to find any evidence that would support a finding that the Lermas did get financing for the purchase. Moore testified that "someone" at Sun World Savings informed her that the Lermas were approved within the 60 day period. However, Ms. Nancy Montes of Mortgage Plus, who took the Lermas' loan application, testified that they were never approved. She stated that a "take out" letter sent out in October 1990 was not final loan approval but a prequalification report that indicates a conditional approval subject to verification and continuing good credit. Ms. Montes further testified that she exhausted all her sources in attempting to get financing for the Lermas. Ultimately, the Lermas were denied credit and were unable to close on the house. The record overwhelmingly supports the jury's finding that the Lermas did not get loan approval for the purchase of the house. Therefore, Moore's first point of error is overruled.

Waiver

[¶8] In its second point of error, Moore asserts that the evidence establishes as a matter of law that the Lermas waived any right to have the earnest money refunded. We agree.

[¶9] Any contractual right can be waived. *Purvis Oil Corp. v. Hillin*, 890 S.W.2d 931, 937 (Tex.App.-El Paso 1994, no writ). A waiver is an intentional release, relinquishment, or surrender of a known right. *Id.* The following elements must be met to find waiver: (1) a right must exist at the time of the waiver; (2) the party who is accused of waiver must have constructive or actual knowledge of the right in question; and (3) the party intended to relinquish its right. See *Riley v. Meriwether*, 780 S.W.2d 919, 922 (Tex.App.-El Paso 1989, writ denied). Intentional relinquishment of a known right can be inferred from intentional conduct which is inconsistent with claiming the contractual right. *Id.*

[¶10] It has been conclusively established that the Lermas did not obtain financing for the purchase of the house from Moore. Paragraph 4 of the contract clearly states that if the purchasers are unable to obtain financing within 60 days of the effective date of the contract, they had a right to have their money returned. Thus, on June 15, 1990, the Lermas had a right to the return of their earnest money. The Lermas' intention to relinquish their right to the return of the earnest money, however, is clearly established by their conduct after June 15. Between the date the contract was signed and the date construction began on the house, the Lermas participated in the design of the house, approved the blueprints in July 1990, and tendered an additional \$6,500 in earnest money to Moore in October. The Lermas were then conditionally approved for financing which allowed Moore to get a construction loan to begin building the house.

[¶11] Additionally, after construction of the house began in December 1990, the Lermas monitored its progress on a daily basis. In March 1991, they requested and paid for an upgrade in tile for the house. In June, Isabel Lerma executed a promissory note in the principal amount of \$6,000 to Moore to pay for the addition of another room to the house. During this same time period, the Lermas sold their home and another property, as agreed in the contract, to fund the down payment. Mr. Lerma testified that he fully intended to buy the house that Moore was building, and at no time prior to August 1991 did he consider the contract terminated. Mrs. Lerma also testified that until August 1991, they wanted and intended to purchase the home.

[¶12] Although the Lermas claim that they were unaware that they could get their money back on that date, both Mr. and Mrs. Lerma signed the contract. Mrs. Lerma testified that she read the contract. Mr. Lerma was not sure if he read the contract, but testified that no one prevented him from doing so. A person who signs a contract is presumed to know and understand its contents; absent a finding of fraud, failure to apprehend the rights and obligations under the contract will not excuse performance. See *G-W-L, Inc. v. Robichaux*, 643 S.W.2d 392 (Tex.1982); *Thigpen v. Locke*, 363 S.W.2d 247 (Tex.1962). There is no

evidence of fraud, actual or constructive, on the part of Moore. Thus, we conclude the Lermas had knowledge of their right to a refund of the earnest money on June 15.

[¶13] There is no evidence to support the jury's finding that the Lermas did not waive the right to have the earnest money refunded. The Lermas' intentional conduct after the right to the return of the earnest money arose was inconsistent with claiming that right. They intentionally relinquished a known right, and therefore, we find as a matter of law, that the Lermas waived Paragraph 4 of the contract, and the contract continued in effect, including Paragraph 11 allowing Moore to retain the earnest money on the lots.

[¶14] The Lermas argue that Paragraph 4 operates as a condition precedent. When the Lermas failed to obtain financing within 60 days, the contract, including any forfeiture provisions, terminated. Thus, the Lermas assert Paragraphs 16 and 11 never became effective. Many Texas cases have construed provisions similar to Paragraph 4 as conditions precedent. See e.g., * * *. We agree with the Lermas that Paragraph 16, a simple default clause included in the preprinted sections of the contract, may not have become effective in the event the Lermas failed to obtain financing within 60 days. In this case, however, we have an additional handwritten provision that is somewhat out of the ordinary and distinguishable from the clauses considered in the cases finding conditions precedent. Under Paragraph 11, the "special provisions" section of the contract, the parties added the phrase "on Lot held more than 60 days, Earnest Money is non-refundable." This brief passage is less than a model of clarity. At first blush, it appears in direct contradiction to Paragraph 4, the termination clause.

[¶15] If a contract is worded so that it can be given a certain or definite legal meaning or interpretation, then it is not ambiguous and the court will construe the contract as a matter of law. *City of Pinehurst v. Spooner Addition Water Co.*, 432 S.W.2d 515, 518 (Tex.1968); *First City Nat'l Bank of Midland v. Concord Oil Co.*, 808 S.W.2d 133, 137 (Tex.App.-El Paso 1991, no writ). There is no allegation in this case that the earnest money contract is ambiguous, and it does not appear to us to be so. Generally, the parties to a contract intend every clause to have some effect and the Court may not ignore any portion of the contract unless there is an irreconcilable conflict. *Ogden v. Dickinson State Bank*, 662 S.W.2d 330, 332 (Tex.1983); *Woods v. Sims*, 154 Tex. 59, 273 S.W.2d 617 (1954). In the interpretation of contracts, the primary concern of courts is to ascertain and to give effect to the intentions of the parties as expressed in the instrument. *Coker v. Coker*, 650 S.W.2d 391, 393 (Tex.1983); *Duracon, Inc. v. Price*, 817 S.W.2d 147, 149 (Tex.App.-El Paso 1991, writ denied). This requires the court to examine and consider the entire instrument and reach a decision so that none of the provisions will be rendered meaningless. *Id.*

[¶16] By its wording, Paragraph 11 is not merely a forfeiture clause subject to the condition precedent stated in Paragraph 4. Paragraph 11 envisions the non-occurrence of the condition (in this case financing obtained within 60 days), references the 60-day provision, and provides for continuation of the contract beyond 60 days. To give effect

to both provisions and render neither meaningless, we must construe the handwritten provision to allow the buyer, at its option, to continue the contract after 60 days in the absence of financing. A condition precedent like any other provision of a contract can be waived. *Purvis Oil Corp.*, 890 S.W.2d at 931. Thus, if financing were not obtained in 60 days, the Lermas could do nothing, the contract would terminate, and the Lermas would be entitled to return of the earnest money. On the other hand, the Lermas could take action to have the lot “held more than 60 days” thereby waiving the right to the return of the earnest money.

[¶17] The record establishes that the Lermas chose the latter option. They worked with Moore on the design of the house, tendered additional earnest money four months after the contract would have expired under Paragraph 4, contracted with Moore to increase the square footage of the house, paid for tile upgrades, and sold both the home they were living in and another property in anticipation of closing on the house when it was completed. The record therefore conclusively establishes that the Lermas waived termination of the contract and instead continued to operate pursuant to the contract under Paragraph 11.

* * * *

[¶18] We must reject the Lermas’ arguments and affirm Moore’s second point of error.

* * * *

CONCLUSION

[¶19] Having sustained Moore’s second point of error, we reverse the judgment of the trial court and render judgment that the Lermas take nothing on their contract * * * cause[] of action.

Questions:

1. Is this a case of express or implied waiver?
2. What facts show the Lermas’ intent? Do you believe the Lermas intended to relinquish their right?
3. Did the Lermas promise to apply for a loan?
4. Is reliance on a waiver necessary for the waiver to have legal effect?
5. What exactly was waived?
6. Can anything be waived? In *Clark v. West*, 86 N.E. 1 (N.Y. 1908), Clark and West contracted for Clark to write a book (and perhaps several books) that West would publish. Clark was to be paid \$2 per page “and if [Clark] abstains from the use of intoxicating liquor and otherwise fulfills his agreements as hereinbefore set forth, he shall be paid an additional

\$4 per page in manner hereinbefore stated.” But, after Clark began writing, he drank, and West knew it, but West told Clark that he would pay \$6 per page notwithstanding Clark’s drinking, or at least that is what Clark later alleged. When West paid only \$2 per page, Clark sued, and West defended by claiming Clark drank. In response, Clark claimed West had waived the requirement of Clark’s abstinence. In return, West argued that Clark’s abstinence was the consideration for the contract, and could not be waived. While the court agreed that the consideration for a contract cannot be waived, the court said that Clark’s writing books—not Clark’s abstinence—was consideration, and Clark’s abstinence was a waivable point. The point of law, though, is not controversial: the consideration of a contract cannot be waived, though we say it differently now: “A material part of the agreed exchange cannot be waived.” Was what the Lermas waived a material part of the agreed exchange?

Note: Retraction of Waivers

Once a waiver occurs, is it binding in the future? In other words, can it be retracted?

To some extent, a waiver is like a contractual modification. It can be characterized as a promise, namely, a promise to accept something that was not acceptable before. West promised that Clark would not forfeit the \$4 per page as a result of Clark’s drinking. If a waiver is viewed in this way, the question is whether the promise is enforceable. One might expect such a promise to be enforceable according to the same doctrines by which any other promise is enforceable.

On the other hand, it is also possible to think of contractual rights as a kind of property, at least after a contract forms. If one thinks this way, then a waiver is like an abandonment of property. West abandoned the contractual right to pay only \$2 per page if Clark drank. If a waiver is viewed in this way, the question is whether the abandoned right may be reclaimed. The answer from property law is generally no. Once property is abandoned, the person abandoning it has no more rights in it. To some extent, the property view is more consistent with our manner of speaking about waivers. We do not usually talk of a breach of a waiver, as we would if the waiver was a promise. We do, on the other hand, sometimes talk of waivers as being retracted, although that makes them sound more like a grant of property rather than an abandonment of it.

Either way one thinks about waivers, one must ask if they can be taken back. For instance, suppose after West grants Clark a waiver, Clark drinks to excess and begins turning in work of lesser quality. Let’s suppose the work is satisfactory but not as good as Clark’s normal work. In that case, West may regret the waiver. If Clark has not finished the book, may West retract the waiver with respect to the remaining pages?

The rule for this scenario is recited in *Fitzgerald v. Hubert Herman, Inc.*, 179 N.W.2d 252 (Mich. App. 1970): “[A]n executory waiver being in the nature of a promise or a contract

must be supported by consideration to be enforceable. But a waiver . . . partaking of the principle of an election needs no consideration . . . and cannot be retracted.”

Some have had trouble understanding this rule on first reading it. The rule divides waivers into two types: executory and “partaking of the principle of an election.” Executory waivers are treated like promises. Those partaking of the principle of an election are treated like abandonments of property. The trick here is to find which waivers are executory, then. What does executory mean? That a thing is incomplete and that some part of it is yet to be done. A contractual performance is executory before it has been completed. So does that help establish the meaning of the rule? Of course, as performance continues, what was executory becomes no longer so.

Here are some hypotheticals against which to test your knowledge:

PROBLEM 5. In the facts of *Clark v. West*, West tells Clark that Clark may drink without forfeiting the \$4 per page West would otherwise have a right to withhold under the contract. When Clark turns in his next installment, pages 220-230 (out of 3,470), West is not pleased with Clark’s work. It is acceptable, but not as good as what Clark had been writing. West therefore sends a letter to Clark stating that West will from the date of the letter’s receipt forward insist that Clark not drink on pain of losing the \$4 per page. Should Clark now drink?

PROBLEM 6. Marco contracted with Andrea that Andrea would deliver to him 22 tons of long grain rice on November 4. Andrea delivered the rice on November 7, at which time Marco accepted it. Two weeks later, Marco called Andrea and informed her that he was declining the rice and that she could pick it up or pay storage for it. He said he was not going to pay her because the rice was late. Must Marco pay?

E. Implied in Law or Constructive Conditions

1. Who Performs First If the Parties Did Not Say

The doctrine of constructive conditions may be the most counter-intuitive doctrine you will study in this class. Most law students never understand the doctrine because they do not see the need for it. They fail to see even the issue that the doctrine addresses.

There was no doctrine of constructive conditions in 1615, when *Nicholas v. Raynbred* was decided. So this case gives you some idea of what occurs when the doctrine is absent.

Don’t be “cowed” by the archaic language. *Assumes* means literally “undertakes,” but in this context it means “promises.” *Assumpsit* means “he has undertaken,” but here it means

either “undertakings” or “promises,” on the one hand, or “an action based on a promise” on the other. *To aver* is to allege. A *writ* is a complaint.

NICHOLAS v. RAYNBRED

King's Bench and Exchequer Chamber (1615), Jenk. 296, 145 ER 215, Hob. 88, 80 ER 238

[¶1] A sells a cow to B for 5*l.* and assumes to deliver her to him at a certain day; at the same time B assumes to A to pay him 5*l.* for the said cow, at the said day. A brings an assumpsit for the 5*l.* not paid, and does not aver delivery of the cow: it need not be averred; but the writ ought to aver the mutual assumpsit; for they are reciprocal assumpsits: and such mutual assumpsits are a good consideration, and each of them has a remedy against the other; one for the cow, and other for the 5*l.*

[¶2] Judged in both courts [the King's Bench and the Exchequer]. * * * *

Questions:

1. Does A have to deliver the cow before he sues for the money? Is delivery of the cow a condition precedent to B's duty to pay the money? Is delivery of the money a condition precedent to A's duty to deliver the cow?

2. How will B get the cow?

3. Let's suppose a court followed *Nicholas* in a sale of property. Suppose A was to deliver not a cow but a deed. Under *Nicholas*, need A deliver the deed before suing for the money?

4. In a case from the 1670s called *Peters v. Opie*, a worker was supposed to build a house in exchange for money. The worker sued the owner but did not allege that he had built the house (or allege that he had done anything at all). The owner argued that the worker had to allege that he had done the work before he could collect the money. What result, under *Nicholas*? In the course of the argument, one judge, Chief Justice Hale, showed his disagreement with the *Nicholas* rule. He said he never let workers win unless they alleged that they had performed; otherwise the owner might be forced to pay, and then sue, a beggar! 2 Keble 837, 84 ER 529, 530 (1671). Imagine, forcing landowners to pay for work before it was done!

5. If the parties choose mutual promises as the form of their exchange, aren't they simply extending credit to each other? They don't have to do that. B could have exchanged her promise of 5*l.* for actual delivery of the cow. That would be a unilateral contract—a promise in exchange for a performance. And A could agree to deliver the deed only after B paid the money. And the landowner could bargain for the completed work in exchange for his promise to pay money. If the parties could easily have protected themselves in this manner (and most did in the days of *Nicholas*), then why should the law step in

paternalistically and protect them from their own folly? *Nicholas* is no longer good law. *Kingston v. Preston* is.

KINGSTON v. PRESTON

King's Bench (1773)

2 Doug. 690, 99 E.R. 437 (report taken from arguments of counsel in *Jones v. Barkley* (1781))

[¶1] [Kingston alleged as follows: Richard Preston was a mercer, a dealer in silks. On March 24, 1770, John Kingston promised to serve Preston as an employee for fifteen months at a salary of £200 per year. Preston promised in exchange that, at the end of fifteen months, Preston would convey his mercer business, including all his inventory, at a “fair valuation” to Kingston and Preston’s nephew, or some other person nominated by Preston, who would become partners in the mercer business for a 14-year period. Kingston, for his part, also promised to accept the mercer business and enter into the partnership. But the partners were to pay for the mercer business over a period of time, presumably out of profits. To induce Preston to allow the partners to pay out of profits, Kingston also promised to “cause and procure good and sufficient security to be given” to Preston, approved by Preston, for the payment of £250 per month to Preston until the debt for the mercer business could be reduced to the value of £4,000.]

[¶2] Then the plaintiff averred, that he had performed, and been ready to perform, his covenants, and assigned for breach on the part of the defendant, that he had refused to surrender and give up his business, at the end of the said year and a quarter. —The defendant pleaded, 1. That the plaintiff did not offer sufficient security; and, 2. That he did not give sufficient security for the payment of the £250, &c. — And the plaintiff demurred generally to both pleas.

[¶3] On the part of the plaintiff, the case was argued by Mr. Buller, who contended, that the covenants were mutual and independant, and, therefore, a plea of the breach of one of the covenants to be performed by the plaintiff was no bar to an action for a breach by the defendant of one of which he had bound himself to perform, but that the defendant might have his remedy for the breach by the plaintiff, in a separate action. On the other side, Mr. Grose insisted, that the covenants were dependent in their nature, and, therefore, performance must be alleged: the security to be given for the money, was manifestly the chief object of the transaction, and it would be highly unreasonable to construe the agreement, so as to oblige the defendant to give up a beneficial business, and valuable stock in trade, and trust, to the plaintiff's personal security, (who might, and, indeed, was admitted to be worth nothing,) for the performance of his part.

[¶4] In delivering the judgment of the Court, Lord Mansfield expressed himself to the following effect: There are three kinds of covenants: 1. Such as are called mutual and independant, where either party may recover damages from the other, for the injury he may have received by a breach of the covenants in his favour, and where it is no excuse for the

defendant, to allege a breach of the covenants on the part of the plaintiff. 2. There are covenants which are conditions and dependent, in which the performance of one depends on the prior performance of another, and, therefore, till this prior condition is performed, the other party is not liable to an action on his covenant. 3. There is also a third sort of covenants, which are mutual conditions to be performed at the same time; and, in these, if one party was ready, and offered, to perform his part, and the other neglected, or refused, to perform his, he who was ready, and offered, has fulfilled his engagement, and may maintain an action for the default of the other; though it is not certain that either is obliged to do the first act. — His Lordship then proceeded to say, that the dependence, or independence, of covenants, was to be collected from the evident sense and meaning of the parties, and, that, however transposed they might be in the deed, their precedency must depend on the order of time in which the intent of the transaction requires their performance. That, in the case before the Court, it would be the greatest injustice if the plaintiff should prevail: the essence of the agreement was, that the defendant should not trust to the personal security of the plaintiff, but, before he delivered up his stock and business, should have good security for the payment of the money. The giving such security, therefore, must necessarily be a condition precedent. - Judgment was accordingly given for the defendant, because the part to be performed by the plaintiff was clearly a condition precedent.

Questions:

1. On what precedent could Buller call on to support Kingston's case? Why?
2. Must Kingston prove that he has given sufficient security before he may sue Preston for breach?
3. Mansfield's opinion actually changes one rule and adds another. Both are necessary for the court to rule for Preston. The first rule is the general default that mutual promises create independent covenants. What does Mansfield change that rule to? What further thing does he add to this case besides dependence?
4. How does Mansfield say the courts should determine which case falls where, in the structure that he creates?
5. How much of Mansfield's opinion actually discerns the intent of the parties? How does Mansfield propose that judges will say in what order the parties should perform?
6. If it's fair that Kingston had to trust Preston for 15 months, while Kingston worked in contemplation that Preston would convey his stock in trade and let Kingston take over the mercer business, without security, isn't it fair to make Preston trust Kingston for a little while, or let Preston sue for failure to obtain security?

7. If Preston didn't want Kingston's promise as consideration, why did he agree to it? If he didn't bargain for Kingston's performance as consideration, why does the court require it? Doesn't that give Preston more than he bargained for?

8. Kingston actually brought a cause of action for debt, not assumpsit, but everyone saw the writing on the wall, and this opinion has been universally adopted. It is still not a bad summary, which is why this area of the law is so counter-intuitive to some students.

GOODISON v. NUNN
King's Bench (1792), 4 T.R. 761, 100 E.R. 1288

Lord Kenyon, Ch.J. - This case is extremely clear, whether considered on principles of strict law or of common justice. The plaintiff engaged to sell an estate to the defendant, in consideration of which the defendant undertook to pay 210*l*; and, if he did not carry the contract into execution, he was to pay 21*l*; and [plaintiff's] now not having conveyed his estate, or offered to do so, or taken any one step towards it, the plaintiff has brought this action for the penalty. Suppose the purchase-money of an estate was 40,000*l*. [I]t would be absurd to say that the purchaser might enforce a conveyance without payment, and compel the seller to have recourse to him, who perhaps might be an insolvent person. The old cases, cited by the plaintiff's counsel, have been accurately stated; but the determinations in them outrage common sense, I admit the principle on which they profess to go: but I think that the Judges misapplied that principle. It is admitted in them all that where they are dependent Covenants, no action will lie by one party unless he have performed, or offered to perform his covenant. Then the question is, whether these are, or are not, dependent covenants? I think they are; the one is to depend on the other; when the one party conveyed his estate he was to receive the purchase-money; and when the other parted with his money he was to have the estate. They were reciprocal acts, to be performed by each other at the same time. It seems, from the case in *Strange*, that the Judges were surprised at the old decisions; and in order to get rid of the difficulty, they said that a tender and refusal would amount to a performance: it is true they went farther, and said that "in consideration of the premises," meant only in consideration of the covenant to transfer, and not in consideration of the actual transferring of the stock: but to the latter part of that judgment I cannot accede. It is our duty, when we see that principles of law have been misapplied, in any case, to overrule it. The principle is admitted in all the cases alluded to, that, if they be dependent covenants, performance, or the offer to perform, must be pleaded on the one part, in order to found the action against the other. The mistake has been in the misapplication of that principle in the cases cited; and I am glad to find that the old cases have been over-ruled; and that we are now warranted by precedent as well as by principle to say that this action cannot be maintained.

Questions:

1. Must Goodison allege payment or tender?
2. How does Kenyon know that the covenants are dependent? What is the test for that?
3. Kenyon's opinion suggests that this problem arose only because the courts held that a promise was consideration for another promise. It is true that courts say that a promise is consideration. They still say that. Kenyon's opinion does not purport to overrule the rule that a mutual promise is consideration. Is it consistent to say that a promise is consideration but that the promisor must actually perform or at least tender performance before the defendant is obligated? What exactly is bargained for when a mutual promise is consideration? If Nunn didn't want Goodison's promise but instead wanted actual payment, why did Nunn promise in exchange for Goodison's promise?

Jeffrey A. PITTMAN v. Lily V. CANHAM
Cal. Ct. App. (1992), 3 Cal. Rptr. 2d 340

OPINION

GILBERT, J.

[¶1] When is a contract no longer a contract? When it contains concurrent conditions and neither party tenders timely performance. Unlike love or taxes, concurrent conditions do not last forever.

[¶2] We hold that where a contract creates concurrent conditions and neither party tenders timely performance, both parties are discharged. We affirm the judgment.

Facts

[¶3] Jeffrey A. Pittman was a licensed real estate broker. In 1987 he contacted Lily V. Canham, then 85 years old, to purchase a parcel of property she owned in San Luis Obispo County. After many telephone calls to Canham between May and November 1987, she agreed to sell a 56-acre parcel to Pittman for \$250,000.

[¶4] Pittman drafted the contract dated November 24, 1987, and deposited \$1,000 in escrow. The contract called for a further deposit of \$24,000 in cash, with the balance of the purchase price to be paid by a note secured by a deed of trust on the property. Closing of escrow was to be within 30 days. The contract provided that "[t]ime is of the essence. All modification or extensions shall be in writing signed by the parties."

[¶5] The parties executed escrow instructions that provided: "Time is of the essence of these instructions. If this escrow is not in condition to close by the Time Limit Date of

December 24, 1987 and written demand for cancellation is received by you from any principal to this escrow after said date, you shall act in accordance with [other provisions of the instructions]. . . . [¶] If no demand for cancellation is made, you will proceed to close this escrow when the principals have complied with the escrow instructions." Paragraph 2 of section 4 of the instructions provided, however, that the instructions were not intended to amend, modify or supersede the contract.

[¶6] About the second week of December Canham gave a signed copy of the escrow instructions to Pittman for delivery to escrow. With the instructions, Canham included a signed deed to the property. The escrow company pointed out, however, that the deed had not been notarized. When Pittman contacted Canham, she told him she would have it notarized at an escrow company near her home.

[¶7] The December 24 closing date came and went. Canham had not tendered a notarized deed nor had Pittman tendered \$24,000, a promissory note or deed of trust.

[¶8] By March 1988, Canham had been contacted by another broker who wanted to list the property. On March 21 she told Pittman she wanted \$10,000 per acre. Pittman embarked on an effort to find out what a fair price for the property was.

[¶9] In May 1988, Canham told Pittman that she had entered into a contract with other purchasers to buy the property for \$600,000. Pittman wrote a letter demanding that she perform on his contract, but she sold the property to the other buyers.

[¶10] Pittman sued Canham for breach of contract. At trial he attributed the difference in the \$250,000 he offered Canham and the \$600,000 sales price six months later to an escalating real estate market.

[¶11] At the end of Pittman's case, Canham moved for a judgment of nonsuit. (Code Civ. Proc., § 581c.) A ruling on the motion was reserved, however, until all the evidence was presented. After the presentation of the evidence, the court granted the motion on the ground that time was of the essence of the contract and neither party tendered performance. The court also gave a statement of decision in which it found that Pittman and not Canham was responsible for the delay in performance, that Canham had not waived time for performance, and that Pittman defaulted when he failed to tender the purchase money, note and deed of trust by December 24, 1987.

Discussion

[¶12] Pittman contends the trial court erred in finding he was in default for failing to tender the purchase money note and deed of trust. He concedes that the result reached by the trial court would be proper if his performance had been a condition precedent, but he points out that here the contract provision requiring Canham to deliver a recordable deed into escrow and the provision requiring him to deposit money, a note and a deed of trust

are concurrent conditions. Pittman claims that unlike the failure to perform a condition precedent, the failure of both parties to perform concurrent conditions does not automatically terminate the contract, but that one party must tender performance before the other party is in default. (Citing *Chan v. Title Ins. & Trust Co.* (1952) 39 Cal. 2d 253 [246 P.2d 632]; *Rubin v. Fuchs* (1969) 1 Cal. 3d 50 [81 Cal.Rptr. 373, 459 P.2d 925]; 1 *Miller & Starr, Cal. Real Estate* (2d ed. 1989) § 1:135, p. 488.)

[¶13] Concurrent conditions are conditions precedent which are mutually dependent, and the only important difference between a concurrent condition and a condition precedent is that the condition precedent must be performed before another duty arises, whereas a tender of performance is sufficient in the case of a concurrent condition. (1 *Witkin, Summary of Cal. Law* (9th ed. 1987) *Contracts*, § 737, pp. 667-668.)

[¶14] Contrary to Pittman's assertion, the failure of both parties to perform concurrent conditions does not leave the contract open for an indefinite period so that either party can tender performance at his leisure. The failure of both parties to perform concurrent conditions during the time for performance results in a discharge of both parties' duty to perform. Thus, where the parties have made time the essence of the contract, at the expiration of time without tender by either party, both parties are discharged. (3A *Corbin on Contracts* (1960) § 663, p. 181.) Here, because time was made the essence of the contract, the failure of both parties to tender performance by December 24, 1987, discharged both from performing. Neither party can hold the other in default and no cause of action to enforce the contract arises. (See *Pitt v. Mallalieu* (1948) 85 Cal. App. 2d 77, 81 [192 P.2d 24].)

[¶15] Pittman relies on the portion of the escrow instructions that states: "Time is of the essence of these instructions. . . . If this escrow is not in condition to close by the Time Limit Date of December 24, 1987 and . . . [i]f no demand for cancellation is made, you will proceed to close this escrow when the principals have complied with the escrow instructions." He claims this provision shows that time was not truly of the essence in this transaction.

[¶16] But it is difficult to see how a paragraph that begins with the words "[t]ime is of the essence" could reasonably be construed as meaning time is not truly of the essence. The provision relied on by Pittman merely instructs the escrow holder not to cancel escrow on its own initiative, but to close escrow should the parties voluntarily and notwithstanding discharge mutually decide to perform. As we read the paragraph, it does not purport to give a party the unilateral right to demand performance after the time for performance has passed. Such a construction would render meaningless the parties' agreement that time is of the essence.

[¶17] We appreciate the reluctance of a buyer to act first by placing money into escrow. But in a contract with concurrent conditions, the buyer and seller cannot keep saying to

one another, "No, you first." Ultimately, in such a case, the buyer seeking enforcement comes in second; he loses. * * * *

[¶18] The judgment is affirmed. Costs are awarded to Canham.

Questions:

1. Is there any contract left at this point?
2. What's the difference between a condition precedent and a concurrent condition?
3. Are concurrent conditions here express conditions?
4. How does the court know they are supposed to be concurrent and not precedent?

From K & G Const. Co. v. Harris, 164 A.2d 451, 455 (Md. 1960):

In the early days, it was settled law that covenants and mutual promises in a contract were prima facie independent, and that they were to be so construed in the absence of language in the contract clearly showing that they were intended to be dependent. Williston, op. cit., ¶816; Page, op. cit., ¶¶2944, 2945. In the case of *Kingston v. Preston*, 2 Doug. 689, decided in 1774, Lord Mansfield, contrary to three centuries of opposing precedents, changed the rule, and decided that performance of one covenant might be dependent on prior performance of another, although the contract contained no express condition to that effect. Page, op. cit., ¶2946; Williston, op. cit., ¶817. The modern rule, which seems to be of almost universal application, is that there is a presumption that mutual promises in a contract are dependent and are to be so regarded, whenever possible. Page, op. cit., ¶2946; Restatement, Contracts, ¶ 266. Cf. Williston, op. cit., ¶812.

Thomas R. MOORE v. Martin KOPEL
Supr. Ct. App. Div. (1997), 237 A.D.2d 124, 653 N.Y.S.2d 927

[¶1] Defendant Martin Kopel, D.V.M., purchased the veterinary practice of Pasquale Campanile, D.V.M., for whom he had worked for the previous six years. Finding the income from the practice less than sufficient to meet the \$20,000 monthly payments to Dr. Campanile, defendant engaged the services of plaintiff Thomas R. Moore, Esq., to seek a reduction in the purchase price, and in certain tax liabilities, in exchange for a contingent fee of one third of whatever reductions were obtained. Plaintiff was successful in obtaining certain reductions in defendant's liabilities and billed defendant for his services. Upon defendant's failure to remit payment, plaintiff brought this action to recover legal fees.

[¶2] Defendant argues that plaintiff failed to perform a condition precedent to collection of his fee pursuant to the parties' written agreement. He further maintains that the agreement presents certain issues of fact with respect to the reasonableness of the fee.

[¶3] Insofar as pertinent, the agreement states:

"Whereas Kopel has engaged Moore to seek to reduce payments from Kopel to Pasquale Campanile, P. C. ('Campanile') and to Federal, State and local tax authorities ('T.A.') and otherwise reduce Kopel's liabilities and debt, and increase Kopel's assets and income,

"Now, therefore, Kopel agrees to pay Moore one-third of any said savings achieved through Moore's efforts in reducing Kopel's payments to Campanile and T.A. and in increasing Kopel's assets and income through refunds or rebates from Campanile and T.A., such payments to be made to Moore by Kopel when such reduced payments are made by Kopel and such refunds or rebates are received by Kopel."

[¶4] Defendant contends that the recitation in the agreement that plaintiff has been engaged, inter alia, to "increase Kopel's assets and income" constitutes a condition precedent. He concludes that plaintiff's failure to demonstrate that there has been an increase in the assets and income of the veterinary practice therefore precludes summary judgment in his favor.

[¶5] We do not agree. The agreement does not employ express language of condition (see, e.g., *Charles Hyman, Inc. v Olsen Indus.*, 227 A.D.2d 270 [joint venture agreement]; *Lindenbaum v Royco Prop. Corp.*, 165 A.D.2d 254 [mortgage contingency clause]), nor has defendant demonstrated that the parties, by the language employed, implicitly agreed that an increase in the assets and income of the practice would be a prerequisite to payment (cf., *World Point Trading PTE v Credito Italiano*, 225 A.D.2d 153, 160; *Calamari and Perillo*, Contracts § 141, at 229-230). While performance of work under a contract is a constructive condition to payment (*Calamari and Perillo*, Contracts § 156, at 244), it is subject to the general rule that payment is due when the promisee has substantially performed his obligations under the agreement (*Calamari and Perillo*, Contracts § 157 [b], at 248). Moreover, it is clear that the basis of compensation, stated in the "Now" clause, is "reducing Kopel's payments" and "increasing Kopel's assets and income through refunds or rebates" (emphasis supplied). Therefore, the recitation to "increase Kopel's assets and income" is not a condition precedent. It is not an express condition. It is not even a constructive condition. It is merely one of the objectives of the contract, as recited in the "Whereas" clause of the agreement. * * * *

[¶6] Order of the Supreme Court, New York County * * * , which, inter alia, denied plaintiff's motion for partial summary judgment as to liability and dismissal of defendants' first and second counterclaims, unanimously reversed, on the law, without costs, the motion granted, and the matter remanded to Supreme Court for assessment of damages.]

Questions:

1. While the court says that “increase Kopel’s assets and income” is not a condition precedent, either express or constructive, what is clearly a constructive condition of payment? One court put the matter obscurely by referring to one performance as *faciendo* and one as *dando*, and saying that, when that is the case, *faciendo* must precede *dando*. *Coletti v. Knox Hat*, 252 N.Y. 468, 472, 169 N.E. 649, 649 (1930). Was Chief Justice Hale correct, then, and do you share his prejudice?

2. Why should a constructive condition be subject to the doctrine of substantial performance, while express condition must be strictly performed?

3. Interestingly, the *Moore v. Kopel* court suggested the application of substantial performance law to what well may have been a unilateral contract. In a unilateral contract, a promise is exchanged for a performance. Because the performance is consideration for the promise, the promise is not binding until the performance is finished. (Section 45 of the Restatement, if adopted, binds the promisor to an option to give the promisee a reasonable time to finish, but the promisor is bound to the promise only if the promisee finishes.) No doctrine of constructive conditions is necessary because the promise is not binding at all, even contingently, until the performance occurs.

A bargain comprising mutual promises is different. There, a binding contract forms when the promises are traded, as *Nicholas v. Raynbred* affirmed. But who is to say whether the promises are conditions of each other, and which should be performed first? That is why we have the doctrine of constructive conditions with its attached order of performance doctrines. We presume the two promises are dependent—are conditioned on the performance of the other. If one promise is for work and the other for payment, then the *Moore* rule applies to show the order of performance.

If the contract in *Moore v. Kopel* was a unilateral contract, then the constructive conditions doctrine was irrelevant. If it was a trade of mutual promises, then the doctrine applied. Can you tell which it was? Does it make a difference as to the result? In either case, performance had to occur before pay was warranted, so the legal result was the same in that case. That it was and is the same in so many other cases is probably why so many lawyers confuse the doctrines. The way the result is reached is very different, however, and the difference is not just a technicality. The doctrines we are about to study—substantial performance, divisible contract, and so on—apply only when the constructive conditions doctrine applies. They do not apply at all to the performance that is consideration in a unilateral contract.

2. Mitigating Doctrines

Having created a doctrine conditioning the duty to perform one of two mutual promises on the prior performance of the other promise, the courts then had to deal with the unintended consequences of their lawmaking. The following doctrines mitigate the

harshness that would otherwise flow from application of the doctrine of constructive conditions.

a. Substantial Performance

JACOB & YOUNGS, INC. v. KENT
N.Y. (1921), 230 N.Y. 239

OPINION OF THE COURT

CARDOZO, J.

[¶1] The plaintiff built a country residence for the defendant at a cost of upwards of \$77,000, and now sues to recover a balance of \$3,483.46, remaining unpaid. The work of construction ceased in June, 1914, and the defendant then began to occupy the dwelling. There was no complaint of defective performance until March, 1915. One of the specifications for the plumbing work provides that "all wrought iron pipe must be well galvanized, lap welded pipe of the grade known as 'standard pipe' of Reading manufacture." The defendant learned in March, 1915, that some of the pipe, instead of being made in Reading, was the product of other factories. The plaintiff was accordingly directed by the architect to do the work anew. The plumbing was then encased within the walls except in a few places where it had to be exposed. Obedience to the order meant more than the substitution of other pipe. It meant the demolition at great expense of substantial parts of the completed structure. The plaintiff left the work untouched, and asked for a certificate that the final payment was due. Refusal of the certificate was followed by this suit.

[¶2] The evidence sustains a finding that the omission of the prescribed brand of pipe was neither fraudulent nor willful. It was the result of the oversight and inattention of the plaintiff's subcontractor. Reading pipe is distinguished from Cohoes pipe and other brands only by the name of the manufacturer stamped upon it at intervals of between six and seven feet. Even the defendant's architect, though he inspected the pipe upon arrival, failed to notice the discrepancy. The plaintiff tried to show that the brands installed, though made by other manufacturers, were the same in quality, in appearance, in market value and in cost as the brand stated in the contract—that they were, indeed, the same thing, though manufactured in another place. The evidence was excluded, and a verdict directed for the defendant. The Appellate Division reversed, and granted a new trial.

[¶3] We think the evidence, if admitted, would have supplied some basis for the inference that the defect was insignificant in its relation to the project. The courts never say that one who makes a contract fills the measure of his duty by less than full performance. They do say, however, that an omission, both trivial and innocent, will sometimes be atoned for by allowance of the resulting damage, and will not always be the breach of a condition to be followed by a forfeiture (*Spence v. Ham*, 163 N. Y. 220; *Woodward v. Fuller*, 80 N. Y. 312; *Glacius v. Black*, 67 N. Y. 563, 566; *Bowen v. Kimbell*, 203 Mass. 364, 370). The distinction is akin to that between dependent and independent promises, or

between promises and conditions (Anson on Contracts [Corbin's ed.], sec. 367; 2 Williston on Contracts, sec. 842). Some promises are so plainly independent that they can never by fair construction be conditions of one another. (Rosenthal Paper Co. v. Nat. Folding Box & Paper Co., 226 N. Y. 313; Bogardus v. N. Y. Life Ins. Co., 101 N. Y. 328). Others are so plainly dependent that they must always be conditions. Others, though dependent and thus conditions when there is departure in point of substance, will be viewed as independent and collateral when the departure is insignificant (2 Williston on Contracts, secs. 841, 842; Eastern Forge Co. v. Corbin, 182 Mass. 590, 592; Robinson v. Mollett, L. R., 7 Eng. & Ir. App. 802, 814; Miller v. Benjamin, 142 N. Y. 613). Considerations partly of justice and partly of presumable intention are to tell us whether this or that promise shall be placed in one class or in another. The simple and the uniform will call for different remedies from the multifarious and the intricate. The margin of departure within the range of normal expectation upon a sale of common chattels will vary from the margin to be expected upon a contract for the construction of a mansion or a 'skyscraper.' There will be harshness sometimes and oppression in the implication of a condition when the thing upon which labor has been expended is incapable of surrender because united to the land, and equity and reason in the implication of a like condition when the subject-matter, if defective, is in shape to be returned. From the conclusion that promises may not be treated as dependent to the extent of their uttermost minutiae without a sacrifice of justice, the progress is a short one to the conclusion that they may not be so treated without a perversion of intention. Intention not otherwise revealed may be presumed to hold in contemplation the reasonable and probable. If something else is in view, it must not be left to implication. There will be no assumption of a purpose to visit venial faults with oppressive retribution.

[¶4] Those who think more of symmetry and logic in the development of legal rules than of practical adaptation to the attainment of a just result will be troubled by a classification where the lines of division are so wavering and blurred. Something, doubtless, may be said on the score of consistency and certainty in favor of a stricter standard. The courts have balanced such considerations against those of equity and fairness, and found the latter to be the weightier. The decisions in this state commit us to the liberal view, which is making its way, nowadays, in jurisdictions slow to welcome it (Dakin & Co. v. Lee, 1916, 1 K. B. 566, 579). Where the line is to be drawn between the important and the trivial cannot be settled by a formula. 'In the nature of the case precise boundaries are impossible' (2 Williston on Contracts, sec. 841). The same omission may take on one aspect or another according to its setting. Substitution of equivalents may not have the same significance in fields of art on the one side and in those of mere utility on the other. Nowhere will change be tolerated, however, if it is so dominant or pervasive as in any real or substantial measure to frustrate the purpose of the contract (Crouch v. Gutmann, 134 N. Y. 45, 51). There is no general license to install whatever, in the builder's judgment, may be regarded as "just as good" (Easthampton L. & C. Co., Ltd., v. Worthington, 186 N. Y. 407, 412). The question is one of degree, to be answered, if there is doubt, by the triers of the facts (Crouch v. Gutmann; Woodward v. Fuller, *supra*), and, if the inferences are certain, by the judges of the law (Easthampton L. & C. Co., Ltd., v. Worthington, *supra*). We must weigh the purpose to be served, the desire to be gratified, the excuse for deviation from the letter, the

cruelty of enforced adherence. Then only can we tell whether literal fulfilment is to be implied by law as a condition. This is not to say that the parties are not free by apt and certain words to effectuate a purpose that performance of every term shall be a condition of recovery. That question is not here. This is merely to say that the law will be slow to impute the purpose, in the silence of the parties, where the significance of the default is grievously out of proportion to the oppression of the forfeiture. The willful transgressor must accept the penalty of his transgression (*Schultze v. Goodstein*, 180 N. Y. 248, 251; *Desmond-Dunne Co. v. Friedman-Doscher Co.*, 162 N. Y. 486, 490). For him there is no occasion to mitigate the rigor of implied conditions. The transgressor whose default is unintentional and trivial may hope for mercy if he will offer atonement for his wrong (*Spence v. Ham*, *supra*).

[¶5] In the circumstances of this case, we think the measure of the allowance is not the cost of replacement, which would be great, but the difference in value, which would be either nominal or nothing. Some of the exposed sections might perhaps have been replaced at moderate expense. The defendant did not limit his demand to them, but treated the plumbing as a unit to be corrected from cellar to roof. In point of fact, the plaintiff never reached the stage at which evidence of the extent of the allowance became necessary. The trial court had excluded evidence that the defect was unsubstantial, and in view of that ruling there was no occasion for the plaintiff to go farther with an offer of proof. We think, however, that the offer, if it had been made, would not of necessity have been defective because directed to difference in value. It is true that in most cases the cost of replacement is the measure (*Spence v. Ham*, *supra*). The owner is entitled to the money which will permit him to complete, unless the cost of completion is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value. Specifications call, let us say, for a foundation built of granite quarried in Vermont. On the completion of the building, the owner learns that through the blunder of a subcontractor part of the foundation has been built of granite of the same quality quarried in New Hampshire. The measure of allowance is not the cost of reconstruction. "There may be omissions of that which could not afterwards be supplied exactly as called for by the contract without taking down the building to its foundations, and at the same time the omission may not affect the value of the building for use or otherwise, except so slightly as to be hardly appreciable" (*Handy v. Bliss*, 204 Mass. 513, 519. Cf. *Foeller v. Heintz*, 137 Wis. 169, 178; *Oberlies v. Bullinger*, 132 N. Y. 598, 601; 2 Williston on Contracts, sec. 805, p. 1541). The rule that gives a remedy in cases of substantial performance with compensation for defects of trivial or inappreciable importance, has been developed by the courts as an instrument of justice. The measure of the allowance must be shaped to the same end.

The order should be affirmed, and judgment absolute directed in favor of the plaintiff upon the stipulation, with costs in all courts.

MCLAUGHLIN, J. (dissenting).

[¶1] I dissent. The plaintiff did not perform its contract. Its failure to do so was either intentional or due to gross neglect which, under the uncontradicted facts, amounted to the same thing, nor did it make any proof of the cost of compliance, where compliance was possible.

[¶2] Under its contract it obligated itself to use in the plumbing only pipe (between 2,000 and 2,500 feet) made by the Reading Manufacturing Company. The first pipe delivered was about 1,000 feet and the plaintiff's superintendent then called the attention of the foreman of the subcontractor, who was doing the plumbing, to the fact that the specifications annexed to the contract required all pipe used in the plumbing to be of the Reading Manufacturing Company. They then examined it for the purpose of ascertaining whether this delivery was of that manufacture and found it was. Thereafter, as pipe was required in the progress of the work, the foreman of the subcontractor would leave word at its shop that he wanted a specified number of feet of pipe, without in any way indicating of what manufacture. Pipe would thereafter be delivered and installed in the building, without any examination whatever. Indeed, no examination, so far as appears, was made by the plaintiff, the subcontractor, defendant's architect, or any one else, of any of the pipe except the first delivery, until after the building had been completed. Plaintiff's architect then refused to give the certificate of completion, upon which the final payment depended, because all of the pipe used in the plumbing was not of the kind called for by the contract. After such refusal, the subcontractor removed the covering or insulation from about 900 feet of pipe which was exposed in the basement, cellar and attic, and all but 70 feet was found to have been manufactured, not by the Reading Company, but by other manufacturers, some by the Cohoes Rolling Mill Company, some by the National Steel Works, some by the South Chester Tubing Company, and some which bore no manufacturer's mark at all. The balance of the pipe had been so installed in the building that an inspection of it could not be had without demolishing, in part at least, the building itself.

[¶3] I am of the opinion the trial court was right in directing a verdict for the defendant. The plaintiff agreed that all the pipe used should be of the Reading Manufacturing Company. Only about two-fifths of it, so far as appears, was of that kind. If more were used, then the burden of proving that fact was upon the plaintiff, which it could easily have done, since it knew where the pipe was obtained. The question of substantial performance of a contract of the character of the one under consideration depends in no small degree upon the good faith of the contractor. If the plaintiff had intended to, and had complied with the terms of the contract except as to minor omissions, due to inadvertence, then he might be allowed to recover the contract price, less the amount necessary to fully compensate the defendant for damages caused by such omissions. (Woodward v. Fuller, 80 N. Y. 312; Nolan v. Whitney, 88 N. Y. 648.) But that is not this case. It installed between 2,000 and 2,500 feet of pipe, of which only 1,000 feet at most complied with the contract. No explanation was given why pipe called for by the contract was not used, nor was any effort made to show what it would cost to remove the pipe of other manufacturers and install that of the Reading Manufacturing Company. The defendant had a right to contract

for what he wanted. He had a right before making payment to get what the contract called for. It is no answer to this suggestion to say that the pipe put in was just as good as that made by the Reading Manufacturing Company, or that the difference in value between such pipe and the pipe made by the Reading Manufacturing Company would be either "nominal or nothing." Defendant contracted for pipe made by the Reading Manufacturing Company. What his reason was for requiring this kind of pipe is of no importance. He wanted that and was entitled to it. It may have been a mere whim on his part, but even so, he had a right to this kind of pipe, regardless of whether some other kind, according to the opinion of the contractor or experts, would have been "just as good, better, or done just as well." He agreed to pay only upon condition that the pipe installed were made by that company and he ought not to be compelled to pay unless that condition be performed. (Schultze v. Goodstein, 180 N. Y. 248; Spence v. Ham, *supra*; Steel S. & E. C. Co. v. Stock, 225 N. Y. 173; Van Clief v. Van Vechten, 130 N. Y. 571; Glacius v. Black, 50 N. Y. 145; Smith v. Brady, 17 N. Y. 173, and authorities cited on p. 185.) The rule, therefore, of substantial performance, with damages for unsubstantial omissions, has no application. (Crouch v. Gutmann, 134 N. Y. 45; Spence v. Ham, 163 N. Y. 220.)

[¶4] What was said by this court in Smith v. Brady (*supra*) is quite applicable here: "I suppose it will be conceded that everyone has a right to build his house, his cottage or his store after such a model and in such style as shall best accord with his notions of utility or be most agreeable to his fancy. The specifications of the contract become the law between the parties until voluntarily changed. If the owner prefers a plain and simple Doric column, and has so provided in the agreement, the contractor has no right to put in its place the more costly and elegant Corinthian. If the owner, having regard to strength and durability, has contracted for walls of specified materials to be laid in a particular manner, or for a given number of joists and beams, the builder has no right to substitute his own judgment or that of others. Having departed from the agreement, if performance has not been waived by the other party, the law will not allow him to allege that he has made as good a building as the one he engaged to erect. He can demand payment only upon and according to the terms of his contract, and if the conditions on which payment is due have not been performed, then the right to demand it does not exist. To hold a different doctrine would be simply to make another contract, and would be giving to parties an encouragement to violate their engagements, which the just policy of the law does not permit." (p. 186.)

[¶5] I am of the opinion the trial court did not err in ruling on the admission of evidence or in directing a verdict for the defendant.

[¶6] For the foregoing reasons I think the judgment of the Appellate Division should be reversed and the judgment of the Trial Term affirmed.

HISCOCK, Ch. J., HOGAN and CRANE, JJ., concur with CARDOZO, J.; POUND and ANDREWS, JJ., concur with MCLAUGHLIN, J.

Order affirmed, etc.

Questions:

1. Did Jacob & Youngs' failure to perform exactly what was in the contract—install Reading pipe—deprive it of its right to Kent's performance?
2. Would this case come out differently if we learned that the president of Reading Pipe had been Jacob's rival since they were kids? Would this case come out differently if we learned that Mrs. Kent had been Miss Reading Pipe in a "scholarship pageant" while in high school?
3. Why is good faith part of this doctrine? Will lack of good faith preclude substantial performance or only make it less likely?
4. Suppose the contract said that payment shall be conditioned on compliance with the requirement that Reading Pipe be installed. Any difference? Would substantial performance be available to Jacobs & Young?
5. If Reading and Cohoes pipe are the same, why doesn't Kent just pay the bill?

TOMPKINS et al. v. DUDLEY
N.Y. (1862), 25 N.Y. 272

DAVIES, J.

[¶1] On the 31st of August, 1857, Cornelius Chambers, by a written contract, agreed to make, erect, build and furnish for the plaintiffs a school-house, according to certain plans and specifications, and to furnish the materials for the sum of \$678.50. The school-house was to be completed on the 1st day of October, 1857. The defendants guaranteed the performance of the contract on the part of the builder. The building was not completed on the 1st day of October, and it was burned down on the night of the 5th of October. The judge who tried the cause found, as matter of fact, that the contract was substantially performed by Chambers, but that the building was not entirely completed according to the specifications, there remaining to be done a small amount of painting and the hanging of the window blinds, and that the same had not been formally accepted nor the key delivered on the 5th of October. This action is brought to recover the money paid on account to Chambers as the building progressed, and for the damages which the plaintiffs have sustained by reason of the non-completion of the contract, the fulfillment of which was guaranteed by the defendants. It is undeniable that the school house was not completed, nor delivered and accepted by the plaintiffs at the time of its destruction. They had a right to insist upon the completion of the contract according to its terms, and the builder did not allege or pretend that he had completed it. A substantial compliance with the terms of the contract will not answer when the contractor, as in this case, admits and concedes that the work was incomplete; he was still in possession, engaged in its completion. According to

the testimony, about \$60 was yet to be expended on the building. Had the builder completed the building and complied with his contract at the time of the destruction of the school house? I am constrained to say he had not. He was not only to complete it in accordance with its terms, but was to deliver it over to the plaintiffs thus finished, or offer to deliver it, before his whole duty was performed. Now it is undeniable that the builder did not do this. A portion of the work was yet to be done; the builder was still in possession, and actually engaged in the work of completion at the time of its destruction. * * * * In *Mucklow v. Mangles* (1 Taunt., 218), which arose out of a contract for building a barge, the whole price was paid in advance, the vessel was built and the name of the person who contracted for it was painted on the stern, yet it was held that the title remained in the builder. LAWRENCE, J., said, "No property vests till the thing is finished and delivered." * * * *

[¶2] The builder, in the present case, by his own contract, created a liability and incurred a duty, which the defendants guaranteed he should perform, and which he has not performed. In justification of such non-performance, he alleges the destruction of the building by fire and inevitable accident, without any fault on his part. The law is well settled, that this is no legal justification for the non-performance of the contract. * * * *

[¶3] The only additional case needful to refer to, is that of *School Trustees of Trenton v. Bennett* (3 Dutcher [N. J.], 514). In that case a person had contracted with the owner of a lot to build, erect and complete a building thereon, and by reason of a latent defect in the soil the building fell down before it was completed, and the Supreme Court of New Jersey held that the loss fell upon the contractor, and that when the contract was, by its terms, to build and complete a building, and find materials for a certain entire price, payable in instalments as the work progresses, the contract is entire, and if the building, either by fault of the builder or by inevitable accident, is destroyed before completion, the owner may recover back the instalments he has paid.

[¶4] The court, in its opinion, says:

"No rule of law is more firmly established by a long train of decisions than this, that where a party, by his own contract, creates a duty or charge upon himself, he is bound to make it good, notwithstanding any accident by inevitable necessity, because he might have provided against it by his contract."

And in reference to the argument of hardship, the court very justly says:

"No matter how harsh and apparently unjust in its operation the rule may occasionally be, it cannot be denied that it has its foundation in good sense and inflexible honesty. The party that agrees to do an act should *do it*, unless absolutely impossible. He should provide against contingencies in his contract. When one of two innocent persons must sustain a loss, the law casts it upon him who has agreed to sustain it, or, rather, the law leaves it where the agreement of the parties has put it; the law will not insert for the benefit of one of the parties, by construction, an exception which the parties have not, either by design or neglect, inserted in their engagement. If a party, for a sufficient consideration, agrees to erect and complete

a building upon a particular spot, and find all the materials, and do all the labor, he must erect and complete it, because he has agreed so to do.”

[¶5] I arrive at the conclusion that the law is well settled that the defence interposed by the defendants constitutes no justification to Chambers, the builder, for the non-performance of his contract with the plaintiffs, and that, having guaranteed for an adequate consideration, expressed therein, its performance, they are liable to respond to the plaintiffs for the damages which they have sustained by reason of such non-performance. If these views are concurred in by my brethren, the judgment appealed from must be reversed, and a new trial should be had, with costs to abide the event.

WRIGHT, GOULD, ALLEN and SMITH, Js., concurred.
Judgment reversed, and new trial ordered.

Questions:

1. Can Chambers keep anything?
2. Did Chambers breach?
3. Did the plaintiff have to allege tender before recovering? Why or why not?
4. What would you advise Chambers if he brought this contract to you to look over just after it was signed?

PROBLEM 7. On March 1, Vendor contracted to sell land to Vendee for \$8,000 and turned over possession of the property. Vendee paid \$2,000 at the time of contracting and agreed to pay \$1,000 by the first of each succeeding month until the total price was paid. Vendor agreed to convey the deed on September 1, the day final payment was due. Vendee fails to make the June 1 payment. Can Vendor recover possession without tendering?

Suppose instead that Vendor agreed to put a deed in escrow at the signing of the contract. Different result?

PROBLEM 8. The following evidence was presented at trial:

The written contract required defendant to install a new roof on plaintiff's home for \$648.00. The contract describes the color of the shingles to be used as "russet glow," which defendant defined as a "brown varied color." Defendant acknowledges that it was his obligation to install a roof of uniform color.

After defendant had installed the new roof, plaintiff noticed that it had streaks which she described as yellow, due to a difference in color or shade of some of the shingles. Defendant agreed to remedy the situation and he removed the

nonconforming shingles. However, the replacement shingles do not match the remainder, and photographs introduced in evidence clearly show that the roof is not of a uniform color. Plaintiff testified that her roof has the appearance of having been patched, rather than having been completely replaced. According to plaintiff's testimony, the yellow streaks appeared on the northern, eastern and southern sides of the roof, and defendant only replaced the non-matching shingles on the northern and eastern sides, leaving the southern side with the yellow streaks still apparent. The result is that only the western portion of the roof is of uniform color.

When defendant originally installed the complete new roof, it used 24 "squares" of shingles. In an effort to achieve a roof of uniform color, five squares were ripped off and replaced. There is no testimony as to the number of squares which would have to be replaced on the southern, or rear, side of the house in order to eliminate the original yellow streaks. Although there is expert testimony to the effect that the disparity in color would not be noticeable after the shingles have been on the roof for about a year, there is testimony to the effect that, although some nine or ten months have elapsed since defendant attempted to achieve a uniform coloration, the roof is still "streaky" on three sides. One of defendant's experts testified that if the shingles are properly applied the result will be a "blended" roof rather than a streaked roof.

In view of the fact that the disparity in color has not disappeared in nine or ten months, and in view of the fact that there is testimony to the effect that it would be impossible to secure matching shingles to replace the nonconforming ones, it can reasonably be inferred that a roof of uniform coloration can be achieved only by installing a completely new roof.

The evidence is undisputed that the roof is a substantial roof and will give plaintiff protection against the elements.

After the roofer did what the facts relate, the roofer filed a lien on the plaintiff's house. The plaintiff sued to get the lien removed and for damages. The roofer counterclaimed for payment for the roof. The plaintiff continued to live in the house. She paid nothing for the roof before suit, because she objected to the work for the reasons related. Does plaintiff owe for the roof? *O.W. Grun Roofing and Constr. Co. v. Cope*, 529 S.W.2d 258 (Tex. App. 1975).

b. Divisibility

Marcus LOWY v. UNITED PACIFIC INS. CO.
Cal. (1967), 67 Cal. 2d 87

McCOMB, J.

[¶1] Plaintiffs appeal from a judgment in favor of defendant Arnold Wolpin (hereinafter referred to as "defendant") on a cross-complaint for damages for breach of an excavation and grading contract.

[¶2] Facts: Plaintiffs, owners and subdividers, entered into a contract with defendant, a licensed contractor, for certain excavation and grading work on lots and streets, together with street improvement work consisting of paving the streets and installing curbs and gutters, in a subdivision containing 89 residential lots.

[¶3] After defendant had performed 98 percent of the contracted excavation and grading work, a dispute arose between the parties regarding payment of \$7,200 for additional work, consisting of importing dirt for fills, necessitated by changes made by plaintiffs in the plans.

[¶4] Defendant ceased performance. Plaintiffs immediately employed others to do street improvement work called for by the contract and thereafter sued defendant and his bonding company for breach of contract. Defendant answered and cross-complained for damages for breach of contract and reasonable services rendered. The trial court determined that plaintiffs were entitled to nothing against defendant and his bonding company and allowed defendant recovery on his cross-complaint.

[¶5] Questions: First. Was the contract between the parties divisible and the doctrine of substantial performance applicable?

[¶6] Yes.

[¶7] The contract provided, in part, as follows: "[Defendant] agrees to provide and pay for all materials, labor, tools, equipment, light, transportation and other facilities necessary for the execution, in a good and workmanlike manner, of all the following described work: Excavation, Grading and Street Improvements in Tracts No. 26589 and 19517 in accordance with plans and specifications . . . and Exhibit 'A' attached hereto"

[¶8] "The price which [plaintiffs] shall pay [defendant] for performing his obligations, as aforesaid or as hereunder set forth, is at the following prices indicated:"

[¶9] "See Exhibits 'A' and 'B' attached hereto." (*Italics added.*)

[¶10] Exhibit "A" states in part: "[Defendant] agrees to furnish all equipment, labor and material necessary for street improvements, onsite and offsite grading, grade and excavation and erosion control on Tracts 26589 and 19517 . . . for the lump sum price of Seventy-Three Thousand, Five Hundred Dollars (\$73,500.00) including, without limitation, all grading, compaction, cleaning, grade and erosion control and dumping, all of which are to be performed to satisfaction of [plaintiffs]. . . ." (Italics added.)

[¶11] The construction of pavement, curbs and gutters is not included in the list of specific items for which the sum of \$73,500 is to be paid.

[¶12] Exhibit "B" lists 45 unit prices ranging from \$.04 to \$4.50 per unit for use in the computation of the amount to be charged for the performance of that part of the street improvement work consisting of paving the streets and installing curbs and gutters. The unit prices are entirely unrelated to excavation and grading.

[¶13] The contract further provides: "In invoicing [plaintiffs], multiply all the final quantities by the unit prices set forth in Exhibit 'B.' All quantities will be determined by Delta Engineering & Surveying Co. and approved by [defendant] and [plaintiffs], with the exception of grading, etc., mentioned in Exhibit 'A' of this Agreement, which is a lump sum price for a complete job without any limitations." (Italics added.)

[¶14] The latter paragraph of the contract shows clearly that the lump sum of \$73,500 was not intended to include payment for paving the streets and installing curbs and gutters.

[¶15] The trial court found that under the contract there were two phases of work to be performed, (1) grading and (2) street improvements; that defendant performed all the terms and conditions thereof relating to grading, except work which could be completed for \$1,470, being 2 percent of the total grading cost contracted for; that defendant performed additional grading work, reasonably worth \$7,200, necessitated by changes in plans on the part of plaintiffs and not attributable to defendant, which additional work was also authorized by plaintiffs through their superintendent; that plaintiffs breached the contract by employing others to do street improvement work and by not making payments to defendant for grading work done by him when due, thereby excusing further performance by defendant; and that defendant was entitled to recover on his cross-complaint for damages, as follows:

Contract price for grading	\$73,500.00
Additional work	<u>7,200.00</u>
	80,700.00
Less amount paid defendant	<u>-60,227.50</u>
	20,472.50
Less credit for uncompleted work	<u>-1,470.00</u>
	19,002.50
Less credit for items paid for defendant's account	<u>-1,166.00</u>
	\$17,836.50

[¶16] The trial court also found that defendant was entitled to reasonable attorney's fees in the sum of \$4,000, the contract providing for reasonable attorney's fees to be awarded to the prevailing party in any action brought to enforce the terms and conditions thereof.

[¶17] The trial court further found that defendant had breached that portion of the contract relating to street improvement work and was not entitled to recover damages for loss of profits in connection therewith.

[¶18] As indicated above, the contract required the performance of two kinds of work. First, certain excavation and grading work was to be done on lots and streets. Thereafter, street improvement work, consisting of paving the streets and installing curbs and gutters was required.

[¶19] Plaintiffs agreed to pay defendant for the excavation and grading work (including street grading work) the sum of \$73,500, as set forth in Exhibit "A" of the contract; and they agreed to pay defendant for the paving of the streets and the installation of curbs and gutters (all commonly called "street improvement work") pursuant to the unit prices set forth in Exhibit "B" of the contract.

[¶20] Accordingly, since the consideration was apportioned, the contract was a severable or divisible one.* (See *Keene v. Harling*, 61 Cal.2d 318, 323 [5] [38 Cal.Rptr. 513, 392 P.2d 273]; *Simmons v. California Institute of Technology*, 34 Cal.2d 264, 275 [14] [209 P.2d 581].)

[¶21] Before defendant commenced the excavation and grading work, for which a lump sum price of \$73,500 was set by the contract, he gave a surety bond for \$73,500. When the excavation and grading work was nearing completion, and it was almost time for work under the second phase to begin, plaintiffs requested that defendant provide a surety bond for "street improvements" in the sum of \$125,000, stating that "no work should be performed on any portion of the street improvement portion of the contract until such bond is furnished." Thus, it is clear that the parties treated the contract as a divisible one.

[¶22] Under the circumstances, the fact that defendant did not perform the second phase of the contract does not prevent his recovering for work done under the first phase.

* Williston defines a divisible contract, as follows: "A contract under which the whole performance is divided into two sets of partial performance, each part of each set being the agreed exchange for a corresponding part of the set of performances to be rendered by the other promisor, is called a divisible contract. Or, as expressed in the cases:

"A contract is divisible where by its terms, 1, performance of each party is divided into two or more parts, and 2, the number of parts due from each party is the same, and 3, the performance of each part by one party is the agreed exchange for a corresponding part by the other party." 96 Williston, *Contracts* (3d ed. 1962) s 860, pp. 252-254.)

[¶23] Defendant did not entirely perform under the first phase of the contract. However, the doctrine of substantial performance, ordinarily applied to building contracts, is here applicable, since the evidence shows that defendant completed 98 percent of the work under the first phase and was prevented from completing the balance through the fault of plaintiffs. * * * *

[¶24] The judgment is affirmed. * * * *

TRAYNOR, C. J., PETERS, J., TOBRINER, J., MOSK, J., BURKE, J., and SULLIVAN, J., concurred.

Questions:

1. Was this contract divisible?
2. What is the legal effect of finding a contract divisible?
3. Did Wolpin substantially perform? A portion?
4. How does the divisible contract doctrine relieve from forfeiture?
5. What about a contract to work for one year at \$1,000 per week. Is that divisible? How about at-will employment? Is that divisible? How?

NEW ERA HOMES CORP. v. FORSTER
N.Y. (1949), 86 N.E.2d 757

DESMOND, J.

[¶1] Plaintiff entered into a written agreement with defendants, to make extensive alterations to defendants' home, the reference therein to price and payment being as follows:

‘All above material, and labor to erect and install same to be supplied for \$3,075.00 to be paid as follows:

\$150.00 on signing of contract,
\$1,000.00 upon delivery of materials and starting of work,
\$1,500.00 on completion of rough carpentry and rough plumbing,
\$425.00 upon job being completed.’

[¶2] The work was commenced and partly finished, and the first two stipulated payments were made. Then, when the ‘rough work’ was done, plaintiff asked for the third installment of \$1,500 but defendants would not pay it, so plaintiff stopped work and brought suit for the whole of the balance, that is, for the two last payments of \$1,500 and \$425. On the trial

plaintiff stipulated to reduce its demand to \$1,500, its theory being that, since all the necessary ‘rough carpentry and rough plumbing’ had been done, the time had arrived for it to collect \$1,500. It offered no other proof as to its damages. Defendants conceded their default but argued at the trial, and argue here, that plaintiff was entitled not to the \$1,500 third payment, but to such amount as it could establish by way of actual loss sustained from defendants’ breach. In other words, defendants say the correct measure of damage was the value of the work actually done, less payments made, plus lost profits. The jury, however, by its verdict gave plaintiff its \$1,500. The Appellate Division, Second Department, affirmed the judgment, and we granted defendants leave to appeal to this court.

[¶3] The whole question is as to the meaning of so much of the agreement as we have quoted above. Did that language make it an entire contract, with one consideration for the doing of the whole work, and payments on account at fixed points in the progress of the job, or was the bargain a severable or divisible one in the sense that, of the total consideration, \$1,150 was to be the full and fixed payment for ‘delivery of materials and starting of work’, \$1,500 the full and fixed payment for work done up to and including ‘completion of rough carpentry and rough plumbing’, and \$425 for the rest. We hold that the total price of \$3,075 was the single consideration for the whole of the work, and that the separately listed payments were not allocated absolutely to certain parts of the undertaking, but were scheduled part payments, mutually convenient to the builder and the owner. That conclusion, we think, is a necessary one from the very words of the writing, since the arrangement there stated was not that separate items of work be done for separate amounts of money, but that the whole alteration project, including material and labor, was ‘to be supplied for \$3,075.00’. There is nothing in the record to suggest that the parties had intended to group, in this contract, several separate engagements, each with its own separate consideration. They did not say, for instance, that the price for all the work up to the completion of rough carpentry and plumbing was to be \$1,500. They did agree that at that point \$1,500 would be due, but as a part payment on the whole price. To illustrate: it is hardly conceivable that the amount of \$150, payable ‘on signing of the contract’ was a reward to plaintiff for the act of affixing its corporate name and seal.

[¶4] We would, in short, be writing a new contract for these people if we broke this single promise up into separate deals; and the new contract so written by us might be, for all we know, most unjust to one or the other party.

[¶5] We find no controlling New York case, but the trend of authority in this State, and elsewhere, is that such agreements express an intent that payment be conditioned and dependent upon completion of all the agreed work. *Tompkins v. Dudley*, 25 N.Y. 272, 82 Am. Dec. 349; *Ming v. Corbin*, 142 N.Y. 334, 37 N.E. 105; *United States v. United States Fidelity & Guaranty Co.*, 236 U.S. 512, 35 S. Ct. 298, 59 L.Ed. 696; *Integrity Floring v. Zandon Corp.*, 130 N.J.L. 244, 32 A.2d 507; *Peist v. Richmond*, 97 Vt. 97, 122 A. 420; 17 C.J.S., *Contracts*, ss 331-334; 1 Restatement, *Contracts*, 2 266, illustration 4 on p. 386. We think that is the reasonable rule after all, a house holder who remodels his home is, usually, committing himself to one plan and one result, not a series of unrelated projects. The parties

to a construction or alteration contract may, of course, make it divisible and stipulate the value of each divisible part. But there is no sign that these people so intended, see *Integrity Flooring v. Zandon*, supra. It follows that plaintiff, on defendants' default, could collect either in quantum meruit for what had been finished, *Heine v. Meyer*, 61 N.Y. 171, or in contract for the value of what plaintiff had lost that is, the contract price, less payments made and less the cost of completion. *Witherbee v. Meyer*, 155 N.Y. 446, 50 N.E. 58; *Washburne v. Property Owners' Co-operative Ass'n of Middlesex Country*, 209 App. Div. 365, 205 N.Y.S. 36, affirmed 240 N.Y. 663, 148 N.E. 749.

[¶6] The judgments should be reversed, and a new trial granted, with costs to abide the event.

[¶7] Loughran, C.J., and Dye, Fuld and Bromley, JJ., concur with Desmond, J.

[¶8] Lewis, J., dissents in opinion in which Conway, J., concurs.

[¶9] Judgements reversed, etc.

Questions:

1. Is this contract divisible under the test given in *Lowy*?
2. Does the formula for damages given by the court put the builder in the position it would have been in had there been no breach?
3. How does the formula protect expectation interests?
4. How does the formula protect reliance interests?
5. Why did the builder want a different formula to be used?

c. Equitable Relief from Forfeiture

William LEWIS v. PREMIUM INVESTMENT CORP.
S.C. (2002), 568 S.E.2d 361

BURNETT, J.

[¶1] The Court granted a writ of certiorari to review the Court of Appeals' decision in *Lewis v. Premium Investment Corp.*, 341 S.C. 539, 535 S.E.2d 139 (Ct.App.2000). We affirm as modified.

FACTS

[¶2] On October 29, 1976, Respondent William Lewis (Purchaser) entered into an installment sales contract to purchase real estate in North Myrtle Beach from Petitioner Premium Investment Corporation (Seller). The contract contains the following default provision:

In the event the Purchaser should fail to make any due installment, and such default shall continue for a period of thirty (30) days, the Seller shall have the right to declare this contract terminated and all amounts previously paid by the Purchaser will be retained by the Seller as rent.

Four months after executing the contract, Purchaser placed a mobile home on the lot and his family moved in. Purchaser made all payments through July 1988.* After July 1988, no further payments were made.

[¶3] In October 1989, one year after Purchaser's default, Seller mailed Purchaser a notice canceling the contract. The notice was returned "unclaimed" to Seller. Although sent by certified mail to the correct address, Purchaser asserts he did not receive the notice.

[¶4] In 1992, Purchaser's wife contacted Seller's representative to determine if he would allow her to assume the payments. The representative passed away without making a commitment.

[¶5] On August 27, 1996, Purchaser's attorney forwarded Seller a check for \$2,451.34. Seller refused to accept the check.

[¶6] At the time of default (August 1988), Purchaser had made 141 of the approximately 182 monthly payments and owed \$2,440.14. The balance as of August 31, 1998, was \$7,726.33.

[¶7] Purchaser brought this action for breach of contract and specific performance. In its amended answer and counterclaim, Seller alleged Purchaser was in default and sought an order terminating the contract. Alternatively, Seller sought judgment in the amount of \$7,443, reasonable attorney's fees, and foreclosure of any equitable interest Purchaser may have obtained as a result of the transaction.†

[¶8] The master-in-equity determined Purchaser was in default of the agreement and Seller had the right to terminate the agreement pursuant to its terms. The Court of Appeals reversed, holding Purchaser had an equitable interest in the property and, therefore, Seller's right to seek forfeiture or to foreclose was subject to Purchaser's right of redemption which could not have been waived by the agreement. *Id.*

* The contract price was \$7,500 plus interest. Purchaser paid \$75.00 as a down payment. Monthly payments were \$75.00.

† The parties agree this is an action in equity. * * * *

ISSUE

[¶9] Did the Court of Appeals err by declining to apply the forfeiture provision of the installment land contract, instead determining Purchaser has an equitable interest in the property which includes a right of redemption upon default?

DISCUSSION

[¶10] Whether an equitable right of redemption exists in spite of a strict forfeiture provision in an installment land contract has not been specifically decided by this Court. In deciding the answer to this question, we must determine whether equitable principles may alter the clear and unambiguous terms of the parties' contract.

Installment Land Contracts

[¶11] Real property is often sold under contracts that provide for the payment of the purchase price in a series of installments. These contracts, usually termed installment land contracts, are drafted in many ways. Typically, the vendor retains legal title to the property until all of the purchase price has been paid . Also typically, the purchaser is entitled to immediate possession . Installment contracts almost always contain forfeiture clauses. When enforced, these clauses enable the vendor to terminate the contract, recover the property, and retain all installments paid when the purchaser defaults.

15 Richard R. Powell, *Real Property* '84D.01 at 3 (2000); *Ellis v. Butterfield*, 98 Idaho 644, 570 P.2d 1334, 1336 (1977) (installment land contract is “frequently called a ‘poor man's mortgage’ because the vendor, as with a mortgage, finances the purchaser's acquisition of the property by accepting installment payments on the purchase price over a period of years, but the purchaser does not receive the benefit of those remedial statutes protecting the rights of mortgagors.”).^{*} Contrary to existing mortgage protections, a seller may typically avoid foreclosure procedures by including a forfeiture remedy in the installment land contract. See Matthew Cole Bormuth, note, *Real Estate B The Wyoming Installment Land Contract: A Mortgage in Sheep's Clothing? Or What You See Isn't What You Get*, 28 *Land and Water Law Review* 309 (1993); Juliet M. Moringiello, *A Mortgage by Any Other Name: A Plea for the Uniform Treatment of Installment Land Contracts and Mortgages under the Bankruptcy Code*, 100 *Dick. L.R.* 733 (1996) (forfeiture remedy makes installment land contract more favorable to vendor than seller-financed mortgage).

^{*} An installment land contract does have advantages for buyers. In addition to immediate possession, installment land contracts offer the benefits of a low down payment and easy credit requirements. Buyers do not have to procure expensive and, sometimes unavailable, traditional mortgage financing. Closing costs are often minimal and, since there is no outside lender, there are no loan origination fees. Eric T. Freyfogle, *Vagueness and the Rule of Law: Reconsidering Installment Land Contract Forfeitures*, 1988 *Duke L.J.* 609.

[¶12] Basic contract law provides that when a contract is clear and unambiguous, the language alone determines the contract's force and effect. * * * *

[¶13] Parties to a contract may stipulate as to the amount of liquidated damages owed in the event of nonperformance. *Tate v. Le Master*, 231 S.C. 429, 99 S.E.2d 39 (1957). Where, however, the sum stipulated is plainly disproportionate to any probable damage resulting from breach of contract, the stipulation is an unenforceable penalty. *Id.*; *Kirkland Distributing Co. of Columbia, S.C. v. United States*, 276 F.2d 138 (4th Cir.1960). Equity will not enforce a penalty for breach of contract. *South Carolina Dep't of Health and Env'tl. Control v. Kennedy*, 289 S.C. 73, 344 S.E.2d 859 (Ct.App.1986). "Equity does not favor forfeitures or penalties and will relieve against them when practicable in the interest of justice." *Lane v. New York Life Ins. Co.*, 147 S.C. 333, 374, 145 S.E. 196, 209 (1928) citing *Bangert v. John L. Roper Lumber Co.*, 169 N.C. 628, 86 S.E. 516, 517 (1915).

[¶14] The above-stated principles of contract law are consistent with the conclusion that a provision in an installment land contract declaring forfeiture in the event of purchaser default can, in particular circumstances, constitute a penalty. In those circumstances, as in other contractual instances where a stipulated sum amounts to a penalty, we conclude it would be inequitable to enforce the forfeiture provision without first allowing the purchaser an opportunity to redeem the installment contract by paying the entire purchase price.

[¶15] Our conclusion is supported by authority from other jurisdictions. In numerous other states, courts claim an equitable power to "deny or delay forfeiture when fairness demands." *Freyfogle*, *supra* 620; see *Hatfield v. Mixon Realty Co.*, 269 Ark. 803, 601 S.W.2d 894 (Ct.App.1980); *Cedar Lane Investments v. American Roofing Supply of Colorado Springs, Inc.*, 919 P.2d 879 (Colo.Ct.App.1996); *Ellis v. Butterfield*, *supra*; *Nelson v. Robinson*, 184 Kan. 340, 336 P.2d 415 (1959); *Perkins v. Penney*, 387 A.2d 205 (Me.1978); *Rothenberg v. Follman*, 19 Mich.App. 383, 172 N.W.2d 845 (1969); *O'Meara v. Olson*, 414 N.W.2d 563 (Minn.Ct.App.1987); *Beck v. Strong*, 572 S.W.2d 484 (Mo.Ct.App.1978); *Sharp v. Holthusen*, 189 Mont. 469, 616 P.2d 374 (1980); *Martinez v. Martinez*, 101 N.M. 88, 678 P.2d 1163 (1984); *Lamberth v. McDaniel*, 131 N.C.App. 319, 506 S.E.2d 295 (1998); *Straub v. Lessman*, 403 N.W.2d 5 (N.D.1987); *T-Anchor Corp. v. Travarillo Assocs.*, 529 S.W.2d 622 (Tex.Civ.App.1975); *Call v. Timber Lakes Corp.*, 567 P.2d 1108 (Utah 1977); *Bailey v. Savage*, 160 W.Va. 523, 236 S.E.2d 203 (1977); see also 4 Richard R. Powell, *Real Property* § 37.21[1] [c] at 132 (2001) ("[t]he main problem with the forfeiture remedy is that it often puts the seller in too favorable a position and, therefore, is subject to attacks based on equitable considerations of unfairness and unconscionability."). In fact, the authoritative treatise on real property law provides, "no state today is likely to condone a purchaser forfeiture that greatly exceeds the vendor's loss." 15 Powell, *Real Property* § 84D.01[4] at 12.

[¶16] As discussed at length in *Bartles v. Livingston*, 282 S.C. 448, 319 S.E.2d 707 (Ct.App.1984), the common law recognized an equitable right of redemption in the context of mortgages well before any statutory right was granted. The mortgagor was given an equitable right to redeem the property irrespective of the terms of the mortgage and this right to redeem was considered an equitable interest in the land. For years, in an executory contract for the sale of land our Court has equated the vendor with the mortgagee and the vendee with the mortgagor. *Dempsey v. Huskey*, 224 S.C. 536, 80 S.E.2d 119 (1954).^{*} There is no equitable reason why the right of redemption should not likewise be afforded to vendees in an installment land contract in appropriate circumstances.

[¶17] For the above reasons, we hold courts of equity can relieve a defaulting purchaser from the strict forfeiture provision in an installment land contract and provide the opportunity for redemption when equity so demands.[†] Accordingly, this matter is remanded to the master-in-equity to determine whether Purchaser has an equitable right of redemption.

[¶18] The decision of the Court of Appeals is AFFIRMED AS MODIFIED.

Questions:

1. The court mentions several items that should be considered in a determination of whether equity should grant relief from forfeiture. Can you generalize these?
2. Other courts asking whether equity should avoid a forfeiture have also considered the degree of fault of the defaulting party and whether the condition that did not occur was a condition precedent or a condition subsequent. In fact, you may use Restatement (Second) of Contracts § 229 as your statement of the rule for relief from forfeiture, as long as you

^{*} The Court of Appeals has specifically held that in an installment land contract, the vendee in possession of the land is considered the owner of an equitable interest in the property. *Southern Pole Bldgs., Inc. v. Williams*, 289 S.C. 521, 347 S.E.2d 121 (Ct.App.1986). We note the right of redemption is distinguishable from an equitable estate which may pass to the purchaser under the theory of equitable conversion. Unlike the equitable right of redemption, the theory of equitable conversion does not apply if the parties provide to the contrary by contract. *Brook v. Council of Co-Owners of Stones Throw Horiz. Prop. Regime I*, 315 S.C. 474, 445 S.E.2d 630 (1994). In this case, the contract provides that, upon default, all amounts previously paid will be retained by Seller as rent. Although this provision may prevent Purchaser from claiming an equitable estate in the property for the amount of the payments made, it cannot defeat his equitable right of redemption.

[†] A variety of case-specific factors should be considered to determine if redemption is equitable under the circumstances. See *Cedar Lane Investments v. American Roofing Supply of Colorado Springs, Inc.*, *supra* (the amount of the purchaser's equity, the length of the default period and the number of defaults, the amount of monthly payments in relation to rental value, the value of improvements to the property, the adequacy of the property's maintenance); *Rothenberg v. Follman*, 19 Mich.App. 383, 172 N.W.2d 845 (1969) (whether forfeiture is unreasonable depends upon amount and length of default, amount of forfeiture, reason for delay in payment, and speed in which equity is sought); 4 Powell, *Real Property* § 37.21[1] at 135 ("In determining whether the attempted forfeiture should be set aside, courts consider the amount of default, the reason for the purchaser's default, the amount of money the purchaser would forfeit compared to the purchase price, and the relationship of the monthly payments to the fair rental value of the property.").

add these two factors to the list. Relief is much more likely in the case of a condition subsequent. One can in fact argue that in the case a condition precedent, nothing can be forfeited, because the failure of the condition means that no benefit ever arises such that it can be forfeited. Was the condition in *Lewis* a condition precedent or subsequent? Which of these is a notice condition for the renewal of a lease?

PROBLEM 9: Juan's garage caught fire and burned. It was separate from the house. Juan quickly called the fire department, and his work with a water hose and the fire department's help with their water contained the fire to the garage and eventually put it out. Juan immediately called his home insurance company to report the loss. The next day, he uploaded pictures to the insurance company's website of various items destroyed by the fire. Juan guessed that it will require around \$35,000 to rebuild the garage and replace the items. An adjuster arrived a few days later, took several hundred pictures, and told Juan that she would file a report. The next day, a fire investigator arrived who also took several hundred pictures. Three weeks later, the insurance company posted a notice to Juan on its website notifying him that it was denying coverage solely because of Juan's failure to file a written claim notifying them of the loss. He checked his policy. Sure enough, it provided as follows:

"Notice of Claim: Written notice of claim must be given to the insurance company within twenty (20) days after the occurrence or commencement of any loss covered by the policy, or as soon thereafter as is reasonably possible. Written notice given by or on behalf of the insured to the insurance company at 435 S. Surety Drive, Actuary, OK 35580, or to any authorized agent of the insurance company, with information sufficient to identify the insured, shall be deemed notice to the insurance company."

Will this provision be enforced? How?

d. Unjust Enrichment

BRITTON v. TURNER
N.H. (1834), 6 N.H. 481

[¶1] ASSUMPSIT for work and labour, performed by the plaintiff, in the service of the defendant, from March 9th, 1831, to December 27, 1831.

[¶2] The declaration contained the common counts, and among them a count in *quantum meruit*, for the labor, averring it to be worth one hundred dollars.

[¶3] At the trial in the C. C. Pleas, the plaintiff proved the performance of the labor as set forth in the declaration.

[¶4] The defence was that it was performed under a special contract—that the plaintiff agreed to work one year, from some time in March, 1831, to March 1832, and that the defendant was to pay him for said year's labor the sum of one hundred and twenty dollars; and the defendant offered evidence tending to show that such was the contract under which the work was done.

[¶5] Evidence was also offered to show that the plaintiff left the defendant's service without his consent, and it was contended by the defendant that the plaintiff had no good cause for not continuing in his employment.

[¶6] There was no evidence offered of any damage arising from the plaintiff's departure, farther than was to be inferred from his non fulfilment of the entire contract.

[¶7] The court instructed the jury, that if they were satisfied from the evidence that the labor was performed, under a contract to labor a year, for the sum of one hundred and twenty dollars, and if they were satisfied that the plaintiff labored only the time specified in the declaration, and then left the defendant's service, against his consent, and without any good cause, yet the plaintiff was entitled to recover, under his *quantum meruit* count, as much as the labor he performed was reasonably worth, and under this direction the jury gave a verdict for the plaintiff for the sum of \$95.

[¶8] The defendant excepted to the instructions thus given to the jury.

[¶9] PARKER, J. delivered the opinion of the court.

[¶10] It may be assumed, that the labor performed by the plaintiff, and for which he seeks to recover a compensation in this action, was commenced under a special contract to labor for the defendant the term of one year, for the sum of one hundred and twenty dollars, and that the plaintiff has labored but a portion of that time, and has voluntarily failed to complete the entire contract.

[¶11] It is clear, then, that he is not entitled to recover upon the contract itself, because the service, which was to entitle him to the sum agreed upon, has never been performed.

[¶12] But the question arises, can the plaintiff, under these circumstances, recover a reasonable sum for the service he has actually performed, under the count in quantum meruit.

[¶13] Upon this, and questions of a similar nature, the decisions to be found in the books are not easily reconciled.

[¶14] It has been held, upon contracts of this kind for labor to be performed at a specified price, that the party who voluntarily fails to fulfil the contract by performing the whole labor contracted for, is not entitled to recover any thing for the labor actually performed,

however much he may have done towards the performance, and this has been considered the settled rule of law upon this subject. [Citations omitted.]

[¶15] That such rule in its operation may be very unequal, not to say unjust, is apparent.

[¶16] A party who contracts to perform certain specified labor, and who breaks his contract in the first instance, without any attempt to perform it, can only be made liable to pay the damages which the other party has sustained by reason of such non performance, which in many instances may be trifling—whereas a party who in good faith has entered upon the performance of his contract, and nearly completed it, and then abandoned the further performance—although the other party has had the full benefit of all that has been done, and has perhaps sustained no actual damage—is in fact subjected to a loss of all which has been performed, in the nature of damages for the non fulfilment of the remainder, upon the technical rule, that the contract must be fully performed in order to a recovery of any part of the compensation.

[¶17] By the operation of this rule, then, the party who attempts performance may be placed in a much worse situation than he who wholly disregards his contract, and the other party may receive much more, by the breach of the contract, than the injury which he has sustained by such breach, and more than he could be entitled to were he seeking to recover damages by an action.

[¶18] The case before us presents an illustration. Had the plaintiff in this case never entered upon the performance of his contract, the damage could not probably have been greater than some small expense and trouble incurred in procuring another to do the labor which he had contracted to perform. But having entered upon the performance, and labored nine and a half months, the value of which labor to the defendant as found by the jury is \$95, if the defendant can succeed in this defence, he in fact receives nearly five sixths of the value of a whole year's labor, by reason of the breach of contract by the plaintiff a sum not only utterly disproportionate to any probable, not to say possible damage which could have resulted from the neglect of the plaintiff to continue the remaining two and an half months, but altogether beyond any damage which could have been recovered by the defendant, had the plaintiff done nothing towards the fulfillment of his contract. * * * *

[¶19] There are other cases, however, in which principles have been adopted leading to a different result.

[¶20] It is said, that where a party contracts to perform certain work, and to furnish materials, as, for instance, to build a house, and the work is done, but with some variations from the mode prescribed by the contract, yet if the other party has the benefit of the labor and materials he should be bound to pay so much as they are reasonably worth. [Citations omitted.] * * * *

[¶21] It is in truth virtually conceded in such cases that the work has not been done, for if it had been, the party performing it would be entitled to recover upon the contract itself, which it is held he cannot do.

[¶22] Those cases are not to be distinguished, in principle, from the present, unless it be in the circumstance, that where the party has contracted to furnish materials, and do certain labor, as to build a house in a specified manner, if it is not done according to the contract, the party for whom it is built may refuse to receive it—elect to take no benefit from what has been performed—and therefore if he does receive, he shall be bound to pay the value—whereas in a contract for labor, merely, from day to day, the party is continually receiving the benefit of the contract under an expectation that it will be fulfilled, and cannot, upon the breach of it, have an election to refuse to receive what has been done, and thus discharge himself from payment.

[¶23] But we think this difference in the nature of the contracts does not justify the application of a different rule in relation to them.

[¶24] The party who contracts for labor merely, for a certain period, does so with full knowledge that he must, from the nature of the case, be accepting part performance from day to day, if the other party commences the performance, and with knowledge also that the other may eventually fail of completing the entire term.

[¶25] If under such circumstances he actually receives a benefit from the labor performed, over and above the damage occasioned by the failure to complete, there is as much reason why he should pay the reasonable worth of what has thus been done for his benefit, as there is when he enters and occupies the house which has been built for him, but not according to the stipulations of the contract, and which he perhaps enters, not because he is satisfied with what has been done, but because circumstances compel him to accept it such as it is, that he should pay for the value of the house.

[¶26] Where goods are sold upon a special contract as to their nature, quality, and price, and have been used before their inferiority has been discovered, or other circumstances have occurred which have rendered it impracticable or inconvenient for the vendee to rescind the contract in toto, it seems to have been the practice formerly to allow the vendor to recover the stipulated price, and the vendee recovered by a cross action damages for the breach of the contract. * * * *

[¶27] So where a person contracts for the purchase of a quantity of merchandize, at a certain price, and receives a delivery of part only, and he keeps that part, without any offer of a return, it has been held that he must pay the value of it. 5 Barn. & Cres. *Shipton v. Casson*; Com. Dig. Action F. *Baker v. Sutton*; 1 Camp. 55, note. * * * *

[¶28] There is a close analogy between all these classes of cases, in which such diverse decisions have been made. * * * *

[¶29] It is as "hard upon the plaintiff to preclude him from recovering at all, because he has failed as to part of his entire undertaking," where his contract is to labor for a certain period, as it can be in any other description of contract, provided the defendant has received a benefit and value from the labor actually performed.

[¶30] We, hold then, that where a party undertakes to pay upon a special contract for the performance of labor, or the furnishing of materials, he is not to be charged upon, such special agreement until the money is earned according to the terms of it, and where the parties have made an express contract the law will not imply and raise a contract different from that which the parties have entered into, except upon some farther transaction between the parties.

[¶31] In case of a failure to perform such special contract, by the default of the party contracting to do the service, if the money is not due by the terms of the special agreement he is not entitled to recover for his labor, or for the materials furnished, unless the other party receives what has been done, or furnished, and upon the whole case derives a benefit from it. 14 Mass. 282, Taft v. Montague; 2 Stark. Ev. 644.

[¶32] But if, where a contract is made of such a character, a party actually receives labor, or materials, and thereby derives a benefit and advantage, over and above the damage which has resulted from the breach of the contract by the other party, the labor actually done, and the value received, furnish a new consideration, and the law thereupon raises a promise to pay to the extent of the reasonable worth of such excess. This may be considered as making a new case, one not within the original agreement, and the party is entitled to "recover on his new case, for the work done, not as agreed, but yet accepted by the defendant." 1 Dane's Abr. 224. * * * *

[¶33] In fact we think the technical reasoning, that the performance of the whole labor is a condition precedent, and the right to recover any thing dependent upon it—that the contract being entire there can be no apportionment—and that there being an express contract no other can be implied, even upon the subsequent performance of service—is not properly applicable to this species of contract, where a beneficial service has been actually performed; for we have abundant reason to believe, that the general understanding of the community is, that the hired laborer shall be entitled to compensation for the service actually performed, though he do not continue the entire term contracted for, and such contracts must be presumed to be made with reference to that understanding, unless an express stipulation shows the contrary.

[¶34] Where a beneficial service has been performed and received, therefore, under contracts of this kind, the mutual agreements cannot be considered as going to the whole of the consideration, so as to make them mutual conditions, the one precedent to the other, without a specific proviso to that effect. 1 H. Black. 273, note, Boone v. Eyre; 6 D. & E. 570, Campbell v. Jones; 10 East, 295, Ritchie v. Atkinson; 4 Taunt. 745, Burn v. Miller.

[¶35] It is easy, if parties so choose, to provide by an express agreement that nothing shall be earned, if the laborer leaves his employer without having performed the whole service contemplated, and then there can be no pretence for a recovery if he voluntarily deserts the service before the expiration of the time.

[¶36] The amount, however, for which the employer ought to be charged, where the laborer abandons his contract, is only the reasonable worth, or the amount of advantage he receives upon the whole transaction, (ante 15, *Wadleigh v. Sutton*,) and, in estimating the value of the labor, the contract price for the service cannot be exceeded. 7 Green. 78; 4 Wendell, 285, *Dubois v. Delaware & Hudson Canal Company*; 7 Wend. 121, *Koon v. Greenman*. * * * *

[¶37] If in such case it be found that the damages are equal to, or greater than the amount of the labor performed so that the employer, having a right to the full performance of the contract, has not upon the whole case received a beneficial service, the plaintiff cannot recover.

[¶38] This rule, by binding the employer to pay the value of the service he actually receives, and the laborer to answer in damages where he does not complete the entire contract, will leave no temptation to the former to drive the laborer from his service, near the close of his term, by ill treatment, in order to escape from payment; nor to the latter in desert his service before the stipulated time, without a sufficient reason; and it will be in most instances settle the whole controversy in one action, and prevent a multiplicity of suits and cross actions. * * * *

[¶39] Applying the principles thus laid down, to this case, the plaintiff is entitled to judgment on the verdict.

[¶40] The defendant sets up a mere breach of the contract in defence of the action, but this cannot avail him. He does not appear to have offered evidence to show that he was damnified by such breach, or to have asked that a deduction should be made upon that account. The direction to the jury was therefore correct, that the plaintiff was entitled to recover as much as the labor performed was reasonably worth, and the jury appear to have allowed a pro rata compensation, for the time which the plaintiff labored in the defendant's service. * * * *

[¶41] Judgment on the verdict.

Questions:

1. What is the measure of Britton's damages?
2. Should willfulness of the breach stop a restitution action?

3. Most hornbooks report *Britton* as the minority rule. I'm not so sure that it is. But there are some courts that affirmatively hold opposite *Britton*. Suppose *Cope* were decided in New Hampshire. Same result?
4. What does Justice Parker mean in [¶15] when he says that the rule "may be very unequal"?
5. Why does Parker say in [¶32] that "a new case" arises, "one not within the original agreement"? Where does the promise to pay in this "new case" come from?
6. Does Parker always insist that the plaintiff's case here is one of *quantum meruit* or unjust enrichment?
7. Aren't you glad you did not write the sentence in [¶33]? Epaphroditus Peck, in *The Law of Persons: Or, Domestic Relations* 275 n.10 (1913), reported that Parker regarded *Britton* "as his chief title to fame; and when he sat for his portrait, ordered by the state of New Hampshire, he held a law book open before him, plainly showing the volume and page of that decision." What did Parker see in the decision, do you suppose (because it obviously wasn't the rhetoric)?
8. Does [¶34] provide an independent ground for the decision?

Ellis SATCHELL v. Derrick V. VAN BRODE
Fla. App. (1971), 248 So.2d 245

PER CURIAM.

[¶1] Plaintiff-appellee Van Brode ("Buyer") sued defendant-appellant Satchell ("Seller") for return of a \$500.00 earnest money deposit on a written purchase-sale agreement for a residence owned by the Seller for \$28,000.00. The Seller counterclaimed for damages for breach of the agreement. A final judgment in a non-jury trial awarded the Buyer his \$500.00 earnest money deposit and denied recovery on the Seller's counterclaim.

[¶2] The contract, which was not drafted by an attorney, contained no provisions for what was to be the disposition of the deposit in the event of a breach.

[¶3] The instant appeal presents the following threshold question: Where a contract for the purchase of real property fails to contain a liquidated damages provision, may the defaulting purchaser recover his \$500.00 earnest money deposit? We express the view that the case is governed by the following rule, which is stated in *Beatty v. Flannery*, Fla. 1950, 49 So.2d 81, 82:

"It is well settled that, even in the absence of such a forfeiture provision, a vendee in default is not entitled to recover from the vendor money paid in part performance of an executory contract." (Citations omitted.)

Accord: *Haas v. Crisp Realty Co.*, Fla. 1953, 65 So.2d 765, 768-769. We note that there are exceptions to the rule quoted, and they are adequately discussed in the cases cited; the exceptions do not apply here.

[¶4] The appellant Seller contends that an adverse judgment on his counterclaim is erroneous. Here, the court sat without a jury and determined the facts, and his findings are clothed with a presumption of correctness. Reversible error not having been demonstrated, that portion of the final judgment is affirmed.

[¶5] For the reasons stated, that portion of the final judgment awarding \$500.00 to the plaintiff-appellee Van Brode, the buyer, is reversed.

Reversed in part and affirmed in part.

Note: In *Beatty v. Flannery*, cited in *Satchell*, the court wrote regarding exceptions:

We recognize that there are exceptions to the general rule that a vendee in default cannot recover, but we find no such circumstances in this case. There was no intimation of fraud on the part of the vendor, nor that the vendee's failure to fulfill the contract was due to any misfortune beyond his control that gave the vendor a benefit, the retention of which was shocking to the conscience of the court. Nor is it here contended that there was a mutual rescission of the contract.

49 So.2d at 82.

Questions:

1. Is *Satchell* inconsistent with *Britton*?
2. *Satchell* is the rule in a great number of American jurisdictions with regard to earnest money. Can you think of reasons for it?
3. What if the vendee had paid half the payments in an installment contract? Same result?
4. Why would one choose *Britton* or *Satchell*?

e. Anticipatory Repudiation

HOCHSTER v. DE LA TOUR
Queen's Bench (1852), 2 Ellis and Blackburn 678, 118 ER 922

* * * *

[¶1] On the trial, before Erle J. at the London sittings in last Easter Term, it appeared that plaintiff was a courier, who, in April, 1852, was engaged by defendant to accompany him on a tour, to commence on 1st June 1852, on the terms mentioned in the declaration. On the 11th May 1852, defendant wrote to plaintiff that he had changed his mind, and declined his services. He refused to make him any compensation. The action was commenced on 22d. May. The plaintiff, between the commencement of the action and the 1st June, obtained an engagement with Lord Ashburton, on equally good terms, but not commencing till 4th July. —The defendant's counsel objected that there could be no breach of the contract before the 1st of June. The learned Judge was of a contrary opinion, but reserved leave to enter a nonsuit on this objection. The other questions were left to the Jury, who found for plaintiff. * * * *

[¶2] Lord Campbell C.J. now delivered the judgment of the Court.

[¶3] On this motion in arrest of judgment, the question arises, Whether, if there be an agreement between A. and B. whereby B. engages to employ A. on and from a future day for a given period of time, to travel with him into a foreign country as a courier, and to start with him in that capacity on that day, A. being to receive a monthly salary during the continuance of such service, B. may, before the day, refuse to perform the agreement and break and renounce it, so as to entitle A. before the day to commence an action against B. to recover damages for breach of the agreement; A. having been ready and willing to perform it, till it was broken and renounced by B. The defendant's counsel very powerfully contended that, if the plaintiff was not contented to dissolve the contract, and to abandon all remedy upon it, he was bound to remain ready and willing to perform it till the day when the actual employment as courier in the service of the defendant was to begin; and

that there could be no breach of the agreement, before that day, to give a right of action. But it cannot be laid down as a universal rule that, where by agreement an act is to be done on a future day, no action can be brought for a breach of the agreement till the day for doing the act has arrived. If a man promises to marry a woman on a future day, and before that day marries another woman, he is instantly liable to an action for breach of promise of marriage; *Short v Stone* (8 Q. B. 358). If a man contracts to execute a lease on and from a future day for a certain term, and, before that day, executes a lease to another for the same term, he may be immediately sued for breaking the contract; *Ford v Tiley* (6 B. & C. 325). So, if a man contracts to sell and deliver specific goods on a future day, and before the day he sells and delivers them to another, he is immediately liable to an action at the suit of the person with whom he first contracted to sell and deliver them; *Bowdell v Parsons* (10 East, 359). One reason alleged in support of such an action is, that the defendant has, before the day, rendered it impossible for him to perform the contract at the day: but this does not necessarily follow; for, prior to the day fixed for doing the act, the first wife may have died, a surrender of the lease executed might be obtained, and the defendant might have repurchased the goods so as to be in a situation to sell and deliver them to the plaintiff. Another reason, may be, that, where there is a contract to do an act on a future day, there is a relation constituted between the parties in the meantime by the contract, and that they impliedly promise that in the meantime neither will do any thing to the prejudice of the other inconsistent with that relation. As an example, a man and woman engaged to marry are affianced to one another during the period between the time of the engagement and the celebration of the marriage. In this very case, of traveller and courier, from the day of the hiring till the day when the employment was to begin, they were engaged to each other; and it seems to be a breach of an implied contract if either of them renounces the engagement. * * * * The declaration in the present case, in alleging a breach, states a great deal more than a passing intention on the part of the defendant which he may repent of, and could only be proved by evidence that he had utterly renounced the contract, or done some act which rendered it impossible for him to perform it. If the plaintiff has no remedy for breach of the contract unless he treats the contract as in force, and acts upon it down to the 1st June 1852, it follows that, till then, he must enter into no employment which will interfere with his promise "to start with the defendant on such travels on the day and year," and that he must then be properly equipped in all respects as a courier for a three months' tour on the continent of Europe. But it is surely much more rational, and more for the benefit of both parties, that, after the renunciation of the agreement by the defendant, the plaintiff should be at liberty to consider himself absolved from any future performance of it, retaining his right to sue for any damage he has suffered from the breach of it. Thus, instead of remaining idle and laying out money in preparations which must be useless, he is at liberty to seek service under another employer, which would go in mitigation of the damages to which he would otherwise be entitled for a breach of the contract. It seems strange that the defendant, after renouncing the contract, and absolutely declaring that he will never act under it, should be permitted to object that faith is given to his assertion, and that an opportunity is not left to him of changing his mind. If the plaintiff is barred of any remedy by entering into an engagement inconsistent with starting as a courier with the defendant on the 1st June, he is prejudiced by putting faith in the defendant's assertion: and

it would be more consonant with principle, if the defendant were precluded from saying that he had not broken the contract when he declared that he entirely renounced it. Suppose that the defendant, at the time of his renunciation, had embarked on a voyage for Australia, so as to render it physically impossible for him to employ the plaintiff as a courier on the continent of Europe in the months of June, July and August 1852: according to decided cases, the action might have been brought before the 1st June; but the renunciation may have been founded on other facts, to be given in evidence, which would equally have rendered the defendant's performance of the contract impossible. The man who wrongfully renounces a contract into which he has deliberately entered cannot justly complain if he is immediately sued for a compensation in damages by the man whom he has injured: and it seems reasonable to allow an option to the injured party, either to sue immediately, or to wait till the time when the act was to be done, still holding it as prospectively binding for the exercise of this option, which may be advantageous to the innocent party, and cannot be prejudicial to the wrongdoer. An argument against the action before the 1st of June is urged from the difficulty of calculating the damages: but this argument is equally strong against an action before the 1st of September, when the three months would expire. In either case, the Jury in assessing the damages would be justified in looking to all that had happened, or was likely to happen, to increase or mitigate the loss of the plaintiff down to the day of trial. We do not find any decision contrary to the view we are taking of this case.

* * * *

[¶4] Upon the whole, we think that the declaration in this case is sufficient. It gives us great satisfaction to reflect that, the question being on the record, our opinion may be reviewed in a Court of Error. In the meantime we must give judgment for the plaintiff.

[¶5] Judgment for plaintiff.

Questions:

1. C.J. Campbell suggests that there is a “relation constituted between the parties in the meantime by the contract, and that they impliedly promise that in the meantime neither will do any thing to the prejudice of the other inconsistent with that relation.” What have we called that relation?
2. What is meant by “passing intention on the part of the defendant which he may repent of”? Can you give an example?
3. Why isn’t this case grounded on impossibility?
4. Why is it necessary to treat renunciation as a breach?
5. What happens if one sues before the duty is due, absent a renunciation?

H.B. TAYLOR v. Elizabeth G. JOHNSTON
Cal. (1975), 123 Cal. Rptr. 641

OPINION

SULLIVAN, J.

[¶1] In this action for damages for breach of contract defendants Elizabeth and Ellwood Johnston, individually and as copartners doing business as Old English Rancho, appeal from a judgment entered after a nonjury trial in favor of plaintiff H.B. Taylor and against them in the amount of \$132,778.05 and costs.

[¶2] Plaintiff was engaged in the business of owning, breeding, raising and racing thoroughbred horses in Los Angeles County. Defendants were engaged in a similar business, and operated a horse farm in Ontario, California, where they furnished stallion stud services. In January 1965 plaintiff sought to breed his two thoroughbred mares, Sunday Slippers and Sandy Fork to defendants' stallion Fleet Nasrullah. To that end, on January 19 plaintiff and defendants entered into two separate written contracts—one pertaining to Sunday Slippers and the other to Sandy Fork. Except for the mare involved the contracts were identical. We set forth in the margin the contract covering Sunday Slippers.*

* [The contract follows:]

"Original IMPORTANT
PLEASE SIGN ORIGINAL AND RETURN AS QUICKLY AS POSSIBLE RETAINING
DUPLICATE FOR YOUR OWN FILE.

January 8, 1965

"OLD ENGLISH RANCHO
Route 1, Box 224-A
Ontario, California 91761

"Gentlemen:

"I hereby confirm my reservation for one services to the stallion FLEET NASRULLAH for the year 1966.

"TERMS: \$3,500.00 — GUARANTEE LIVE FOAL.

"FEE is due and payable on or before Sept. 1, 1966.

"IF stud fee is paid in full, and mare fails to produce a live foal (one that stands and nurses without assistance) from this breeding, a return breeding the following year to said mare will be granted at no additional stallion fee.

"FEE is due and payable prior to sale of mare or prior to her departure from the state. If mare is sold or leaves the state, no return breeding will be granted.

"STUD CERTIFICATE to be given in exchange for fees paid.

"VETERINARIAN CERTIFICATE due in lieu of payment if mare is barren.

"I hereby agree that OLD ENGLISH RANCHO shall in no way be held responsible for accidents of any kind or disease.

Mr. H.B. Taylor

[¶3] The contract provided that Fleet Nasrullah was to perform breeding services upon the respective mares in the year 1966 for a fee of \$3,500, payable on or before September 1, 1966. If the stud fee was paid in full and the mares failed to produce a live foal (one that stands and nurses without assistance) from the breeding a return breeding would be provided the following year without additional fee.

[¶4] On October 4, 1965, defendants sold Fleet Nasrullah to Dr. A.G. Pessin and Leslie Combs II for \$1,000,000 cash and shipped the stallion to Kentucky. Subsequently Combs and Pessin syndicated the sire by selling various individuals 36 or 38 shares, each share entitling the holder to breed one mare each season to Fleet Nasrullah. Combs and Pessin each reserved three shares.

[¶5] On the same day defendants wrote to plaintiff advising the latter of the sale and that he was "released" from his "reservations" for Fleet Nasrullah.* Unable to reach defendants by telephone, plaintiff had his attorney write to them on October 8, 1965, insisting on performance of the contracts. Receiving no answer, plaintiff's attorney on October 19 wrote a second letter threatening suit. On October 27, defendants advised plaintiff by letter that arrangements had been made to breed the two mares to Fleet Nasrullah in Kentucky.† However, plaintiff later learned that the mares could not be boarded at Spendthrift Farm where Fleet Nasrullah was standing stud and accordingly arranged with Clinton Frazier of Elmhurst Farm to board the mares and take care of the breeding.

[¶6] In January 1966 plaintiff shipped Sunday Slippers and Sandy Fork to Elmhurst Farm. At that time, however, both mares were in foal and could not be bred, since this can occur only during the five-day period in which they are in heat. The first heat period normally occurs nine days, and the second heat period thirty days, after foaling. Succeeding heat periods occur every 21 days.

"Mare: SUNDAY SLIPPERS
Roan filly 1959
MOOLAH BUX-MAOLI-ORMESBY
112 North Evergreen Street
Burbank, California 91505
"(Veterinary certificate must accompany all barren mares.)
"Stakes winner of \$64,000.00 last raced in 1962

/s/ H.B. Taylor"

* Defendants' letter stated in part: "We wish to inform you that FLEET NASRULLAH has been sold and will stand the 1966 season in Kentucky. You are, therefore, released from your reservations made to the stallion."

† Defendants' letter stated in part: "Mr. Johnston has made arrangements for you to breed SANDY FORK . . . and SUNDAY SLIPPERS . . . to FLEET NASRULLAH for the 1966 season. Therefore, you should communicate with Dr. A.G. Pessin of Spendthrift Farm, Lexington, Kentucky, to finalize breeding arrangements. . . ."

[¶7] On April 17, 1966, Sunday Slippers foaled and Frazier immediately notified Dr. Pessin. The latter assured Frazier that he would make the necessary arrangements to breed the mare to Fleet Nasrullah. On April 26, the ninth day after the foaling, Frazier, upon further inquiry, was told by Dr. Pessin to contact Mrs. Judy who had charge of booking the breedings and had handled these matters with Frazier in the past. Mrs. Judy, however, informed Frazier that the stallion was booked for that day but would be available on any day not booked by a shareholder. She indicated that she was acting under instructions but suggested that he keep in touch with her while the mare was in heat.

[¶8] Sunday Slippers came into heat again on May 13, 1966. Frazier telephoned Mrs. Judy and attempted to book the breeding for May 16.* She informed him that Fleet Nasrullah had been reserved by one of the shareholders for that day, but that Frazier should keep in touch with her in the event the reservation was cancelled. On May 14 and May 15 Frazier tried again but without success; on the latter date, Sunday Slippers went out of heat.

[¶9] On June 4, the mare went into heat again. Frazier again tried to book a reservation with Fleet Nasrullah but was told that all dates during the heat period had been already booked. He made no further efforts but on June 7, on plaintiff's instructions, bred Sunday Slippers to a Kentucky Derby winner named Chateaugay for a stud fee of \$10,000.

[¶10] Sandy Fork, plaintiff's other mare awaiting the stud services of Fleet Nasrullah, foaled on June 5, 1966. Frazier telephoned Mrs. Judy the next day and received a booking to breed the mare on June 14, the ninth day after foaling. On June 13, 1966, however, she cancelled the reservation because of the prior claim of a shareholder. Frazier made no further attempts and on June 14 bred Sandy Fork to Chateaugay.

[¶11] Shortly after their breeding, it was discovered that both mares were pregnant with twins. In thoroughbred racing twins are considered undesirable since they endanger the mare and are themselves seldom valuable for racing. Both mares were therefore aborted. However, plaintiff was not required to pay the \$20,000 stud fees for Chateaugay's services because neither mare delivered a live foal.

[¶12] The instant action for breach of contract proceeded to trial on plaintiff's fourth amended complaint, which alleged two causes of action, the first for breach of the two written contracts, the second for breach of an oral agreement. Defendants cross-complained for the stud fees. The court found the facts to be substantially as stated above and further found and concluded that by selling Fleet Nasrullah defendants had "put it out of their power to perform properly their contracts," that the conduct of defendants and their agents Dr. Pessin and Mrs. Judy up to and including June 13, 1966, constituted a breach[†] and

* Frazier did not seek to breed Sunday Slippers on May 13, 1966, because the mare's follicle had not yet ruptured; conception can occur up to 12 hours after rupture of the follicle. Accordingly, Frazier normally tried to book a breeding for three days after the onset of heat.

[†] We set forth the significant paragraph of the findings at length: "When defendants sold Fleet Nasrullah in 1965 to a purchaser who shipped him to Kentucky, defendants put it out of their power to perform properly

plaintiff "was then justified in treating it as a breach and repudiation of their contractual obligations to him," and that defendants unjustifiably breached the contracts but plaintiff did not.* The court awarded plaintiff damages for defendants' breach in the sum of \$103,122.50 (\$99,800 net damage directly sustained plus \$3,322.50 for reasonable costs and expenses for mitigation of damages). "Because of defendants' wholly unwarranted, high-handed, and oppressive breach of their contractual obligation to plaintiff, the plaintiff is entitled to recover from the defendants pre-judgment interest at the rate of 7% per annum on the sum of \$99,800.00 from August 1, 1968. . . ." It was concluded that defendants should take nothing on their cross-complaint. Judgment was entered accordingly. This appeal followed.

[¶13] Defendants' main attack on the judgment is two-pronged. They contend: first, that they did not at any time repudiate the contracts; and second, that they did not otherwise breach the contracts because performance was made impossible by plaintiff's own actions. To put it another way, defendants argue in effect that the finding that they breached the contracts is without any support in the evidence. Essentially they take the position that on the uncontradicted evidence in the record, as a matter of law there was neither anticipatory nor actual breach. As will appear, we conclude that the trial court's decision was based solely on findings of anticipatory breach and that we must determine whether such decision is supported by the evidence.

[¶14] Nevertheless both aspects of defendants' argument require us at the outset to examine the specifications for performance contained in the contracts. (See fn. 1, ante.) We note that the reservation for "one services" for Fleet Nasrullah was "for the year 1966." As the evidence showed, a breeding is biologically possible throughout the calendar year, since mares regularly come into heat every 21 days, unless they are pregnant. The contracts therefore appear to contemplate breeding with Fleet Nasrullah at any time during the calendar year 1966. The trial court made no finding as to the time of performance called for by the contracts.† There was testimony to the effect that by custom in the thoroughbred racing business the breeding is consummated in a "breeding season" which normally

their contracts with plaintiff. Those contracts did not require that plaintiff's rights to the breeding services of Fleet Nasrullah should be relegated to a secondary or subordinate position to that of any other person, whether he be a holder of shares in the stallion or not. No such conditions were stated in the contracts and none can be inferred therefrom. From the conduct of the defendants, their agent Dr. Pessin, and their subagent Mrs. Judy, plaintiff was justified in concluding that the defendants were just giving him the runaround and had no intention of performing their contract in the manner required by its terms and as required by the covenant of good faith and fair dealing. Their conduct and that of their agent Dr. Pessin, and their subagent Mrs. Judy up to and including June 13, 1966 constituted a breach of defendants' breeding contracts with plaintiff (plaintiff's Exhibits 8, 9 and 10) and plaintiff was then justified in treating it as a breach and repudiation of their contractual obligation to him."

* The court concluded that "The defendants unjustifiably breached these contracts; the plaintiff did not breach these contracts."

† The trial court was not compelled to specify the exact time for performance because it concluded that defendants had breached the contracts by anticipatory repudiation, i.e., a breach which occurs prior to the time for performance.

extends from January until early July, although some breeding continues through August. It is possible that the parties intended that the mares be bred to Fleet Nasrullah during the 1966 breeding season rather than the calendar year 1966.*

[¶15] However, in our view, it is immaterial whether the contract phrase "for the year 1966" is taken to mean the above breeding season or the full calendar year since in either event the contract period had not expired by June 7 and June 14, 1966, the dates on which Sunday Slippers and Sandy Fork respectively were bred to Chateaugay[†] and by which time, according to the findings (see fn. 5, ante) defendants had repudiated the contracts. There can be no actual breach of a contract until the time specified therein for performance has arrived. (*Gold Min. & Water Co. v. Swinerton* (1943) 23 Cal.2d 19, 29 [142 P.2d 22]; 1 Witkin, Summary of Cal. Law (8th ed.) § 629, p. 536; see Rest. 2d Contracts (Tent. Draft No. 8, 1973) § 260.) Although there may be a breach by anticipatory repudiation: "[b]y its very name an essential element of a true anticipatory breach of a contract is that the repudiation by the promisor occur before his performance is due under the contract." (*Gold Min. & Water Co. v. Swinerton*, supra, 23 Cal.2d at p. 29.) In the instant case, because under either of the above interpretations the time for performance had not yet arrived, defendants' breach as found by the trial court was of necessity an anticipatory breach and must be analyzed in accordance with the principles governing such type of breach. To these principles we now direct our attention.

[¶16] Anticipatory breach occurs when one of the parties to a bilateral contract repudiates the contract. The repudiation may be express or implied. An express repudiation is a clear, positive, unequivocal refusal to perform (*Guerrieri v. Severini* (1958) 51 Cal.2d 12, 18 [330 P.2d 635]; *Gold Min. & Water Co. v. Swinerton*, supra, 23 Cal.2d 19, 29; *Whitney Inv. Co. v. Westview Dev. Co.* (1969) 273 Cal. App.2d 594, 602-603 [78 Cal. Rptr. 302]; *Atkinson v. District Bond Co.* (1935) 5 Cal. App.2d 738, 743-744 [43 P.2d 867]); an implied repudiation results from conduct where the promisor puts it out of his power to perform so as to make substantial performance of his promise impossible (*Zogarts v. Smith* (1948) 86 Cal. App.2d 165 [194 P.2d 143]; 1 Witkin, Summary of Cal. Law (8th ed.) § 632, pp. 538-539; 4 Corbin, Contracts (1951) § 984, pp. 949-951).

[¶17] When a promisor repudiates a contract, the injured party faces an election of remedies: he can treat the repudiation as an anticipatory breach and immediately seek damages for breach of contract, thereby terminating the contractual relation between the parties, or he can treat the repudiation as an empty threat, wait until the time for performance arrives and exercise his remedies for actual breach if a breach does in fact occur at such time. (*Guerrieri v. Severini*, supra, 51 Cal.2d 12, 18-19.) However, if the

* Perhaps the fact that the stud fees were due to be paid September 1, 1966, at the close of the breeding season supports such a conclusion. Moreover, defendants concede without argument that the trial court impliedly found the time of performance to be the breeding season.

[†] Both Sunday Slippers and Sandy Fork would have had at least one more heat during the 1966 breeding season — that of Sunday Slippers commencing on June 26, 1966, and that of Sandy Fork commencing on July 7, 1966.

injured party disregards the repudiation and treats the contract as still in force, and the repudiation is retracted prior to the time of performance, then the repudiation is nullified and the injured party is left with his remedies, if any, invocable at the time of performance. (Id., at pp. 19-20; *Salot v. Wershow* (1958) 157 Cal. App.2d 352, 357-358 [320 P.2d 926]; see *Cook v. Nordstrand* (1948) 83 Cal. App.2d 188, 194-195 [188 P.2d 282]; *Atkinson v. District Bond Co.*, supra, 5 Cal. App.2d 738, 743-744.

[¶18] As we have pointed out, the trial court found that the whole course of conduct of defendants and their agents Dr. Pessin and Mrs. Judy from the time of the sale of Fleet Nasrullah up to and including June 13, 1966, amounted to a repudiation which plaintiff was justified in treating as an anticipatory breach. (See fn. 5, ante.) However, when the principles of law governing repudiation just described are applied to the facts constituting this course of conduct as found by the trial court, it is manifest that such conduct cannot be treated as an undifferentiated continuum amounting to a single repudiation but must be divided into two separate repudiations.

[¶19] First, defendants clearly repudiated the contracts when, after selling Fleet Nasrullah and shipping him to Kentucky, they informed plaintiff "[y]ou are, therefore, released from your reservations made to the stallion." However, the trial court additionally found that "[p]laintiff did not wish to be 'released' from his 'reservations' . . . insist[ed] on performance of the stud service agreements . . . [and] threaten[ed] litigation if the contracts were not honored by defendants. . . ." Accordingly defendants arranged for performance of the contracts by making Fleet Nasrullah available for stud service to plaintiff in Kentucky through their agents Dr. Pessin and Mrs. Judy. Plaintiff elected to treat the contracts as in force and shipped the mares to Kentucky to effect the desired performance. The foregoing facts lead us to conclude that the subsequent arrangements by defendants to make Fleet Nasrullah available to service plaintiff's mares in Kentucky constituted a retraction of the repudiation. Since at this time plaintiff had not elected to treat the repudiation as an anticipatory breach* and in fact had shipped the mares to Kentucky in reliance on defendants' arrangements, this retraction nullified the repudiation. Thus, plaintiff was then left with his remedies that might arise at the time of performance.

[¶20] The trial court found that after the mares had arrived in Kentucky, had delivered the foals they were then carrying and were ready for servicing by Fleet Nasrullah, plaintiff was justified in concluding from the conduct of defendants, their agent Dr. Pessin, and their subagent Mrs. Judy, that "defendants were just giving him the runaround and had no intention of performing their contract in the manner required by its terms" and in treating such conduct "as a breach and repudiation of their contractual obligation to him." (See fn. 5, ante.) Since, as we have explained, defendants retracted their original repudiation, this subsequent conduct amounts to a finding of a second repudiation.

* Plaintiff concedes that the repudiation was not "accepted by plaintiff."

[¶21] There is no evidence in the record that defendants or their agents Dr. Pessin and Mrs. Judy ever stated that Sunday Slippers and Sandy Fork would not be serviced by Fleet Nasrullah during the 1966 breeding season or that they ever refused to perform. Frazier, plaintiff's agent who made arrangements for the breeding of the mares admitted that they had never made such a statement to him.* Accordingly, there was no express repudiation or unequivocal refusal to perform. (*Guerrieri v. Severini*, supra, 51 Cal.2d 12, 18; *Atkinson v. District Bond Co.*, supra, 5 Cal. App.2d 738, 743-744.)

[¶22] The trial court's finding of repudiation, expressly based on the "conduct of the defendants" and their agents suggests that the court found an implied repudiation. However, there is no implied repudiation, i.e., by conduct equivalent to unequivocal refusal to perform, unless "the promisor puts it out of his power to perform." (*Zogarts v. Smith*, supra, 86 Cal. App.2d 165, 172-173; 1 Witkin, Summary of Cal. Law (8th ed.) § 632, p. 538; 4 Corbin, Contracts, supra, § 984, pp. 949-951; Rest. 2d Contracts (Tent. Draft No. 8, 1973) §§ 268, 274.) Once the mares arrived in Kentucky, defendants had the power to perform the contracts; Fleet Nasrullah could breed with the mares. No subsequent conduct occurred to render this performance impossible. Although plaintiff was subordinated to the shareholders with respect to the priority of reserving a breeding time with Fleet Nasrullah, there is no evidence in the record that this subordination of reservation rights rendered performance impossible. Rather it acted to postpone the time of performance, which still remained within the limits prescribed by the contracts. It rendered performance more difficult to achieve; it may even have cast doubt upon the eventual accomplishment of performance; it did not render performance impossible.†

[¶23] Because there was no repudiation, express or implied, there was no anticipatory breach. Plaintiff contends that defendants' conduct, as found by the trial court, indicated that "defendants were just giving him the runaround and had no intention of performing their contract" and therefore that this conduct was the equivalent of an express and unequivocal refusal to perform. Plaintiff has not presented to the court any authority in California in support of his proposition that conduct which has not met the test for an implied repudiation, i.e. conduct which removed the power to perform, may nonetheless be held to amount to the equivalent of an express repudiation and thus constitute an anticipatory breach. Without addressing ourselves to the question whether some conduct

* "Q. . . . At any time, did Mrs. Judy or anyone else ever tell you that she could not or would not breed either mare to Fleet Nasrullah before the end of 1966? . . .

"THE WITNESS: No."

† Plaintiff suggests that this conduct, namely delaying plaintiff's breeding until a day not reserved by a shareholder, amounted to an anticipatory breach because Mrs. Judy inserted a condition to defendants' performance, which as the trial court found was not contemplated by the contracts. Assuming arguendo that this conduct might have amounted to a breach of contract by improperly delaying performance, at most it would have constituted only a partial breach—insufficiently material to terminate the contracts (see Rest. 2d Contracts (Tent. Draft No. 8, 1973) §§ 262, 266, 268, 274). It did not constitute a repudiation of the contracts which was the sole basis of the trial court's decision since "[t]o justify the adverse party in treating the renunciation as a breach, the refusal to perform must be of the whole contract or of a covenant going to the whole consideration. . . ." (*Atkinson v. District Bond Co.*, supra, 5 Cal. App.2d 738, 743.)

could ever be found equal to an express repudiation, we hold that defendants' conduct in this case as a matter of law did not constitute an anticipatory breach.

[¶24] To constitute an express repudiation, the promisor's statement, or in this case conduct, must amount to an unequivocal refusal to perform: "A mere declaration, however, of a party of an intention not to be bound will not of itself amount to a breach, so as to create an effectual renunciation of the contract; for one party cannot by any act or declaration destroy the binding force and efficacy of the contract. To justify the adverse party in treating the renunciation as a breach, the refusal to perform must be of the whole contract . . . and must be distinct, unequivocal and absolute." (*Atkinson v. District Bond Co.*, *supra*, 5 Cal. App.2d 738, 743.)

[¶25] To recapitulate, Sandy Fork was in foal in January 1966, the commencement of the 1966 breeding season, and remained so until June 5, 1966. Throughout this period Fleet Nasrullah could not perform his services as contracted due solely to the conduct of plaintiff in breeding Sandy Fork in 1965. Biologically the first opportunity to breed Sandy Fork was on June 14, 1966, nine days after foaling. Frazier telephoned Mrs. Judy on June 6, 1966, and received a booking with Fleet Nasrullah for June 14, 1966. On June 13 Mrs. Judy telephoned Frazier and informed him she would have to cancel Sandy Fork's reservation for the following day because one of the shareholders insisted on using that day. Mrs. Judy gave no indication whatsoever that she could not or would not breed Sandy Fork on any of the following days in that heat period or subsequent heat periods. Frazier made no further attempts to breed Sandy Fork with Fleet Nasrullah. Thus, plaintiff, who delayed the possibility of performance for five months, asserts that the delay of performance occasioned by defendants' cancellation of a reservation on the first day during the six-month period that plaintiff made performance possible amounts to an unequivocal refusal to perform, even though there was adequate opportunity for Fleet Nasrullah to perform within the period for performance specified in the contract and even though defendants never stated any intention not to perform. We conclude that as a matter of law this conduct did not amount to an unequivocal refusal to perform and therefore did not constitute an anticipatory breach of the contract covering Sandy Fork.

[¶26] Sunday Slippers foaled on April 17, 1966, first came into heat on April 26 and then successively on May 13 and June 4, 1966. Mrs. Judy informed Frazier that she would breed Sunday Slippers on any day that one of the shareholders did not want to use the stallion. Frazier unsuccessfully sought to breed the mare on April 26, May 14, May 15 and June 4, 1966, Fleet Nasrullah being reserved on those dates. Mrs. Judy continued to assure Frazier that the breeding would occur. Sunday Slippers was due to come into heat again twice during the breeding season: June 25 and July 16, 1966. At most this conduct amounts to delay of performance and a warning that performance might altogether be precluded if a shareholder were to desire Fleet Nasrullah's services on all the remaining days within the period specified for performance in which Sunday Slippers was in heat. We conclude that as a matter of law this conduct did not amount to an unequivocal refusal to perform and therefore did not constitute an anticipatory breach of the contract covering Sunday Slippers.

[¶27] In sum, we hold that there is no evidence in the record supportive of the trial court's finding and conclusion that defendants repudiated and therefore committed an anticipatory breach of the contracts. * * * *

The judgment is reversed.

Questions:

1. Did anticipatory repudiation occur?
2. What would be smoking gun evidence of implied anticipatory repudiation before the mares' owners agreed to ship them to Kentucky?
3. Suppose the shareholders said, "We have sold the horse, but you must be able to breed your mares this month or not at all"—would that be anticipatory repudiation?
4. Why wasn't forcing the mare owners to go to Kentucky a breach?
5. Why wasn't having to wait for the shareholders a breach?
6. Suppose a vendor of land conveys it to another person. Is that anticipatory repudiation?
7. Suppose a vendee of land discovers before closing that the vendor's Aunt Lulu, a living person but not a party to the contract, has an interest in the land by inheritance. Is that a repudiation?
8. If the mare owners failed to show that the stud owner breached in Kentucky, then how should we characterize what happened to the contract, legally?
9. In order to sue for stud fees, does the stud owner have to show that it kept Fleet Nasrullah available?

AMF, INC. v. McDONALD'S CORP.
7th Cir. U.S. Ct. App. (1976), 536 F.2d 1167

CUMMINGS, Circuit Judge.

[¶1] AMF, Incorporated, filed this case in the Southern District of New York in April 1972. It was transferred to the Northern District of Illinois in May 1973. AMF seeks damages for the alleged wrongful cancellation and repudiation of McDonald's Corporation's ("McDonald's") orders for sixteen computerized cash registers for installation in restaurants owned by wholly-owned subsidiaries of McDonald's and for seven such registers ordered by licensees of McDonald's for their restaurants. In July 1972, McDonald's of Elk Grove, Inc. sued AMF to recover the \$20,385.28 purchase price paid for a prototype computerized cash register and losses sustained as a result of failure of the equipment to function satisfactorily. Both cases were tried together during a fortnight in December 1974. A few months after the completion of the bench trial, the district court rendered a memorandum opinion and order in both cases in favor of each defendant. The only appeal is from the eight judgment orders dismissing AMF's complaints against McDonald's and the seven licensees.* We affirm. * * * *

[¶2] In 1966, AMF began to market individual components of a completely automated restaurant system, including its model 72C computerized cash register involved here. The 72C cash register then consisted of a central computer, one to four input stations, each with a keyboard and cathode ray tube display, plus the necessary cables and controls.

[¶3] In 1967 McDonald's representatives visited AMF's plant in Springdale, Connecticut, to view a working "breadboard" model 72C to decide whether to use it in McDonald's restaurant system. Later that year, it was agreed that a 72C should be placed in a McDonald's restaurant for evaluation purposes.

[¶4] In April 1968, a 72C unit accommodating six input stations was installed in McDonald's restaurant in Elk Grove, Illinois. This restaurant was a wholly-owned subsidiary of McDonald's and was its busiest restaurant. Besides functioning as a cash register, the 72C was intended to enable counter personnel to work faster and to assist in providing data for accounting reports and bookkeeping. McDonald's of Elk Grove, Inc. paid some \$20,000 for this prototype register on January 3, 1969. AMF never gave McDonald's warranties governing reliability or performance standards for the prototype.

* AMF's lawsuits against said licensees were governed by the parent case and were dismissed in the light of the district court's memorandum opinion and order entered in AMF's case against McDonald's.

[¶5] At a meeting in Chicago on August 29, 1968, McDonald's concluded to order sixteen 72C's for its company-owned restaurants and to cooperate with AMF to obtain additional orders from its licensees. In December 1968, AMF accepted McDonald's purchase orders for those sixteen 72C's. In late January 1969, AMF accepted seven additional orders for 72C's from McDonald's licensees for their restaurants. Under the contract for the sale of all the units, there was a warranty for parts and service. AMF proposed to deliver the first unit in February 1969, with installation of the remaining twenty-two units in the first half of 1969. However, AMF established a new delivery schedule in February 1969, providing for deliveries to commence at the end of July 1969 and to be completed in January 1970, assuming that the first test unit being built at AMF's Vandalia, Ohio, plant was built and satisfactorily tested by the end of July 1969. This was never accomplished.

[¶6] During the operation of the prototype 72C at McDonald's Elk Grove restaurant, many problems resulted, requiring frequent service calls by AMF and others. Because of its poor performance, McDonald's had AMF remove the prototype unit from its Elk Grove restaurant in late April 1969.

[¶7] At a March 18, 1969, meeting, McDonald's and AMF personnel met to discuss the performance of the Elk Grove prototype. AMF agreed to formulate a set of performance and reliability standards for the future 72C's, including "the number of failures permitted at various degrees of seriousness, total permitted downtime, maximum service hours and cost." Pending mutual agreement on such standards, McDonald's personnel asked that production of the twenty-three units be held up and AMF agreed.

[¶8] On May 1, 1969, AMF met with McDonald's personnel to provide them with performance and reliability standards. However, the parties never agreed upon such standards. At that time, AMF did not have a working machine and could not produce one within a reasonable time because its Vandalia, Ohio, personnel were too inexperienced. After the May 1st meeting, AMF concluded that McDonald's had cancelled all 72C orders. The reasons for the cancellation were the poor performance of the prototype, the lack of assurances that a workable machine was available and the unsatisfactory conditions at AMF's Vandalia, Ohio, plant where the twenty-three 72C's were to be built.

[¶9] On July 29, 1969, McDonald's and AMF representatives met in New York. At this meeting it was mutually understood that the 72C orders were cancelled and that none would be delivered.

[¶10] In its conclusions of law, the district court held that McDonald's and its licensees had entered into contracts for twenty-three 72C cash registers but that AMF was not able to perform its obligations under the contracts (see note, 1, *supra*). Citing Section 2-610 of the Uniform Commercial Code (Ill.Rev.Stats. (1975) ch. 26, § 2-610) and Comment 1 thereunder, the court concluded that on July 29, McDonald's justifiably repudiated the contracts to purchase all twenty-three 72C's.

[¶11] Relying on Section 2-609 and 2-610 of the Uniform Commercial Code (Ill.Rev.Stats. (1975) ch. 26, §§ 2-609 and 2-610), the court decided that McDonald's was warranted in repudiating the contracts and therefore had a right to cancel the orders by virtue of Section 2-711 of the Uniform Commercial Code (Ill.Rev.Stats. (1975) ch. 26, § 2-711). Accordingly, judgment was entered for McDonald's. * * * *

[¶12] Whether in a specific case a buyer has reasonable grounds for insecurity is a question of fact. Comment 3 to UCC § 2-609; Anderson, Uniform Commercial Code, § 2-609 (2d Ed. 1971). On this record, McDonald's clearly had "reasonable grounds for insecurity" with respect to AMF's performance. At the time of the March 18, 1969, meeting, the prototype unit had performed unsatisfactorily ever since its April 1968 installation. Although AMF had projected delivery of all twenty-three units by the first half of 1969, AMF later scheduled delivery from the end of July 1969 until January 1970. When McDonald's personnel visited AMF's Vandalia, Ohio, plant on March 4, 1969, they saw that none of the 72C systems was being assembled and learned that a pilot unit would not be ready until the end of July of that year. They were informed that the engineer assigned to the project was not to commence work until March 17th. AMF's own personnel were also troubled about the design of the 72C, causing them to attempt to reduce McDonald's order to five units. Therefore, under Section 2-609 McDonald's was entitled to demand adequate assurance of performance by AMF.*

[¶13] However, AMF urges that Section 2-609 of the UCC * * * is inapplicable because McDonald's did not make a written demand of adequate assurance of due performance. In *Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co.*, 532 F.2d 572, 581 (7th Cir. 1976), we noted that the Code should be liberally construed[†] and therefore rejected such "a formalistic approach" to Section 2-609.[‡] McDonald's failure to make a written demand was excusable because AMF's Mr. Dubosque's testimony and his April 2 and 18, 1969, memoranda about the March 18th meeting showed AMF's clear understanding that

* McDonald's was justified in seeking assurances about performance standards at the March 18th meeting. The parts and service warranty in the contracts for the twenty-three 72C's was essentially a limitation of remedy provision. Under UCC § 2-719(2) (Ill.Rev.Stats. (1975) ch. 26, § 2-719(2)) if the 72C cash registers failed to work or could not be repaired within a reasonable time, the limitation of remedy provision would be invalid, and McDonald's would be entitled to pursue all other remedies provided in Article 2. See , 673 (5th Cir. 1971); , 985-987 (Hawaii 1975). Because McDonald's would have a right to reject the machines if they proved faulty after delivery and then to cancel the contract, it was consistent with the purposes of Section 2-609 for McDonald's to require assurances that such eventuality would not occur. See Comment 1 to UCC § 2-719.

[†] UCC Section 1-102(1) provides that the Code "shall be liberally construed and applied to promote its underlying purposes and policies" (Ill.Rev.Stats. (1975) ch. 26, § 1-102(1)).

[‡] * * * A passing reference was made to UCC Section 609's written requirement for a demand in *National Ropes, Inc. v. National Diving Service, Inc.*, 513 F.2d 53, 61 (5th Cir. 1975). However, the court held that Section 2-609 was not applicable because there was no finding that the seller had reasonable grounds for insecurity and because the record would not support such a finding.

McDonald's had suspended performance until it should receive adequate assurance of due performance from AMF (Tr. 395; AMF Exhibit 79; McD. Exhibit 232).

[¶14] After the March 18th demand, AMF never repaired the Elk Grove unit satisfactorily nor replaced it. Similarly, it was unable to satisfy McDonald's that the twenty-three machines on order would work. At the May 1st meeting, AMF offered unsatisfactory assurances for only five units instead of twenty-three. The performance standards AMF tendered to McDonald's were unacceptable because they would have permitted the 72C's not to function properly for 90 hours per year, permitting as much as one failure in every fifteen days in a busy McDonald's restaurant. Also, as the district court found, AMF's Vandalia, Ohio, personnel were too inexperienced to produce a proper machine. Since AMF did not provide adequate assurance of performance after McDonald's March 18th demand, UCC Section 2-609(1) permitted McDonald's to suspend performance. When AMF did not furnish adequate assurance of due performance at the May 1st meeting, it thereby repudiated the contract under Section 2-609(4). At that point, Section 2-610(b) (note 3 supra) permitted McDonald's to cancel the orders pursuant to Section 2-711 (note 6, supra), as it finally did on July 29, 1969. * * * *

[¶15] Judgment Affirmed.

Questions:

1. Did McDonald's have reasonable grounds for insecurity?
2. But McDonald's didn't make a demand in writing. Does that matter?
3. Did AMF give adequate assurance?
4. Assuming you answered "no" to 3, what is McDonald's remedy?
5. Is insolvency of the performing party reasonable grounds?
6. Karl Llewellyn, principle drafter of Article 2 of the UCC, wanted the doctrine of substantial performance to apply to the sale of goods. Did he get his wish?
7. Section 251 of the Restatement (Second) of Contracts suggests that the UCC doctrine applied here also be adopted into the common law of contracts. Should it? Can you argue that it is effectively already the law? \Many states have explicitly applied section 251 to contracts not covered by the UCC.

Roger DIAMOND v. UNIVERSITY OF SOUTHERN CALIFORNIA
Cal. App. (1970), 11 Cal. App. 3d 49

Opinion

KAUS, P.J.

[¶1] Plaintiff, an attorney, who in this class action represents himself and about six hundred others “similarly situated,” appeals from a judgement in defendant’s favor. * * *

[¶2] The complaint was filed on December 9, 1968, two weeks after defendant’s football team had been selected to play in the Rose Bowl game on January 1, 1969. It contained the following allegations: before the start of the 1968 football season defendant had offered to sell to the public so-called “economy” season tickets, promising that each buyer of such a ticket would be given an option to purchase a Rose Bowl ticket, if the team were to be selected to play there. Plaintiff and the members of his class purchased economy season tickets for the 1968 season. This was the first time they had done so. After the team’s selection for the Rose Bowl game, on or about December 4, 1968, instead of the promised application for a Rose Bowl ticket, plaintiff received a note to the effect that for reasons beyond defendant’s control, first time economy season ticket holders could not be furnished with such applications. The note, however, thanked plaintiff for his support of Trojan football. From the receipt of this note plaintiff concluded that defendant had breached its contract with all first time economy season ticket holders, each of who was alleged to have been damaged in the sum of \$12, the difference between the market value of a Rose Bowl ticket and the price which defendant would have charged, had it fulfilled its agreement. Since, according to the complaint, the total number of season tickets purchased by the six hundred members of plaintiff’s class was three thousand, total damages alleged are \$36,000. The complaint also prays for costs, attorney fees, “such other relief as the court deems just and proper” and “[t]hat upon rendition of judgement against defendant as a condition of participation in said judgement by any of the other parties plaintiff similarly situated, that such party pay [a] proportionate share to plaintiff of the cost and expenses of this litigation.” A demurrer was overruled on January 6, 1969. In the meanwhile the game had become history.

[¶3] On January 23, 1969, defendant filed its notice of motion for summary judgement which was accompanied by the declaration of Elton D. Phillips, the business manager of defendant and the chairman of its “Football Ticket Committee.”

[¶4] According to Mr. Phillips’ declaration the university had sold a total of 46,052 season tickets for the 1968 football season, all with the representation that the purchaser would receive an option to buy a Rose Bowl ticket. After the selection of defendant’s team to play in the Rose Bowl, the Pasadena Tournament of Roses Association allotted defendant 53,003 tickets of which 10,590 were to go to certain “specifically named groups,

companies and associations.” This left 42,513 tickets for the 46,052 season ticket holders. A system of priorities was then established and first time economy season ticket holders were given the lowest priority. Applications for Rose Bowl tickets were then mailed to all other season ticket holders. They contained a proviso that orders for tickets had to be mailed to defendant no later than December 4, 1968. Between December 8 and December 16 it appeared that a sufficient number of season ticket holders had not availed themselves of their option so that it became possible to send applications for tickets to those who had previously received none, this is to say, the first time economy ticketed holders. This was done on December 17.

[¶5] It thus appeared that, somewhat belatedly, defendant met its obligation to the members of plaintiff’s class. * * * *

[¶6] Defendant’s motion for summary judgment was granted on February 10, 1969, and the judgement from which this appeal is taken was entered on March 4.

[¶7] Admittedly the sole purpose of the appeal is to vindicate plaintiff’s right to attorney’s fees.

[¶8] Plaintiff reasons that he is entitled to attorney’s fees on the following analysis:

1. The notice of December 4 was an anticipatory repudiation of defendant’s obligation to furnish plaintiff with a ticket application.
2. The filing of the action on December 9 was a change in position which terminated defendant’s power to retract the repudiation. * * * *

[¶9] Plaintiff’s argument breaks down at step one. Granting, at least for the sake of argument, that the filing of an action is a sufficient change in position to destroy the power to retract an anticipatory repudiation of a contract, plaintiff forgets that, logically or not, it is the general rule, recognized in this state, that the doctrine of breach by anticipatory repudiation does not apply to contracts which are unilateral in their inception or have become so by complete performance by one party. [Citations omitted.] The theory underlying this rule is that since the plaintiff has no future obligations to perform, he is not prejudiced by having to wait for the arrival of the defendant’s time for performance in order to sue for breach. [More citations deleted.]

[¶10] It is quite evident that when defendant repudiated its obligation on December 4, the contract had become unilateral. Plaintiff and the members of his class had done all that they had ever been obligated to do, that is to pay the price of a season ticket. Nothing was left but for defendant to furnish the applications of the Rose Bowl Tickets. The action was, therefore, premature.

Questions:

1. Under the rule from *Diamond*, is it possible for an insurance company to anticipatorily breach an annuity contract? If the promisor in the annuity contract, usually an insurance company, files bankruptcy, should the rule preclude the annuitant's claim?
2. You might think that consumers who buy cars on multi-year finance contracts might also be unable to commit an anticipatory breach. However, the point is moot because finance companies always write into the finance contract a clause dealing with early breach. What does the clause require, do you suppose?
3. Not every court is so stuffy. Can you identify the rationale against the *Diamond* rule in the following case?

POLLACK v. POLLACK
Commission of Appeals of Texas, Section A (1932), 46 S.W.2d 292

[¶1] * * * * After the rendition of the judgement overruling the first motion for rehearing, the Supreme Court has permitted Henry Pollack to file a second motion for rehearing, such permission being also granted on our recommendation.

[¶2] In our original opinion we held: "In this connection we hold that Henry, having not only failed and refused to meet the monthly payment due on the contract, but, on the other hand, having absolutely repudiated the obligation, all without just excuse, has breached the contract, and therefore Charles is entitled to maintain his action in damages at once for the entire breach, and is entitled in one suit to receive in damages the present value of all that he would have received if the contract had been performed, and he is not compelled to resort to repeated suite to recover the monthly payments.["] * * * *

[¶3] The contract made the basis of this suit is set out in full in our original opinion, and in the interest of brevity we will not repeat it here. By its terms Charles conveys to Henry all the property therein described, and Henry, in consideration for such conveyance, agrees to pay Charles \$5,000 per year, in equal monthly installments as long as Charles lives, provided Henry outlive Charles, and in such event such monthly installments fully satisfy the contract. The contract then further provides that, in the event Henry should die before Charles, he (Henry) will bequeath to Charles property, real or personal, or both, of the value of \$100,000. The contract further provides that, in the event Charles and the representatives, devisees, etc., of Henry cannot agree upon a partition of Henry's estate so as to enable Charles to take property therefrom of value of \$100,000, then so much of Henry's estate shall be sold as shall be necessary to pay Charles \$100,000.

[¶4] In the second motion for a rehearing in this court counsel for Henry for the first time contends that we were in error in applying the doctrine of anticipatory breach to this case because the record shows that the contract out of which this suit originated has been

fully performed by Charles, and is still executory only as to Henry. In this connection Henry contends that the rule anticipatory breach only applies to contracts still executory on both sides. [Citations omitted.]

[¶5] In our opinion this contract is not absolutely performed on the part of Charles. * *

[¶6] However, even should we treat the contract as fully performed by Charles, and yet to be performed on the part of Henry only, we are of the opinion that the rule of anticipatory breach should still be applied, because every reason that can be given for applying the rule to the one instance applies with equal force to the other. The doctrine which excepts contracts fully performed by one side from the general rule is purely arbitrary, and without foundation in any logical reason.

[¶7] Simply stated, the rule of anticipatory breach is founded on the theory that the repudiation of the contract by one of the parties to it before the time of performance has arrived amounts to a tender of a breach of the entire contract, and, if it is accepted by the other party, it constitutes what is known in law as an anticipatory breach of such contract as a whole, and in such event the injured party is at liberty to at once demand his damages for such breach, and, if necessary, begin an action therefor. The damages are to be ascertained as of date of the breach, but such damages are to be full compensation for the loss occasioned by depriving plaintiff of the benefit of the contract. The doctrine of anticipatory breach is not founded on the theory that it moves the performance ahead of the time provided in the contract, but on the theory that, when a party bound to perform under the contract repudiates it and denies his liability thereunder, he thereby wrongfully destroys the contract so far as he is able to do so, and is liable for damages for such wrongful act. Also, since the injury is to the contract as a whole, the measure of damages is the value of the thing injured or destroyed regarded as an article of property. Segwick on Damages, Vol 2, p. 1249, § 636-d. It is also held that the promisee has a right to have the contract kept open and recognized as an article of property, and as a valid, subsisting, and effective contract. The repudiation of the contract denies the promisee all of these rights. * * *

[¶8] We are aware of the fact that the rule adhered to by the English authorities, where the doctrine of anticipatory breach originated, only applies same to contracts still to be performed, in whole or in part, by both sides. We are further aware of the fact that the great weight of authority in America adheres to the English rule. Notwithstanding all this, we are constrained to hold that, since to except contracts performed on one side from the rule violates every reason that can be given for its existence in the first instance, and since this court has never committed itself to the exception, it should not now do so. * * * *

[¶9] I perceive no reason for believing that the plaintiffs, by reason of having performed their part of the contract, are in a less favorable position than if the contract was still executory as to them. * * * *

[¶10] It is evident from the above [omitted discussion] that Judge Van Devanter understood the exception to go no further than money contracts, pure and simple. The exception is thus announced in many of the authorities. In other words, it is stated in many of the authorities that the rule of anticipatory breach does not apply to money contracts, pure and simple, which have been fully performed on one side. * * * * The contract under consideration here is certainly not a money contract, pure and simple. Be that as it may, we are of the opinion that the rule of anticipatory breach should be applied without distinction to contracts still to be performed on both sides and those fully executed by one side, and we are further of the opinion that no distinction should be made between contracts to pay money, pure and simple, and other such contracts.

[¶11] We recommend that the second motion for rehearing filed herein by Henry Pollack, plaintiff in error, be in all things overruled.

Question: Which of the two cases, *Diamond* or *Pollack*, is more consistent with the doctrine of constructive conditions?

f. Perfect Tender

Uniform Commercial Code § 2-601

The following case not a reliable precedent. It has not been reversed or overruled, but it takes a position opposite that of other cases on this same issue, and it runs counter to the code. Please do not follow it (unless I tell you that you are arguing Connecticut law in the federal District of Connecticut). Instead, follow the perfect tender rule, a rule taught clearly in this case.

D.P. TECHNOLOGY CORP. v. SHERWOOD TOOL, INC.
D.Conn. (1990), 751 F. Supp. 1038

RULING ON DEFENDANT'S MOTION TO DISMISS

NEVAS, District Judge.

[¶1] In this action based on diversity jurisdiction, the plaintiff seller, D.P. Technology ("DPT"), a California corporation, sues the defendant buyer, Sherwood Tool, Inc. ("Sherwood") a Connecticut corporation, alleging a breach of contract for the purchase and sale of a computer system. Now pending is the defendant's motion to dismiss, pursuant to Rule 12(b)(6), Fed.R. Civ.P., for failure to state a claim upon which relief can be granted. For the reasons that follow, the defendant's motion to dismiss is denied.

I.

A.

[¶2] The facts of this case can be easily summarized. On January 24, 1989, the defendant entered into a written contract to purchase a computer system, including hardware, software, installation and training, from the plaintiff. The complaint alleges that the computer system was "specifically" designed for the defendant and is not readily marketable. The contract*, executed on January 24, 1989, incorporates the delivery term set forth in the seller's Amended Letter of January 17, 1989 stating that the computer system would be delivered within ten to twelve weeks. The delivery period specified in the contract ended on April 18, 1989. The software was delivered on April 12, 1989 and the hardware was delivered on May 4, 1989. On May 9, 1989, the defendant returned the merchandise to the plaintiff, and has since refused payment for both the software and the hardware. Thus, the plaintiff alleges that the defendant breached the contract by refusing to accept delivery of the goods covered by the contract while the defendant argues that it was rather the plaintiff who breached the contract by failing to make a timely delivery.

B.

[¶3] In considering a motion to dismiss under Rule 12(b)(6), Fed.R.Civ.P., for failure to state a claim upon which relief can be granted, a court is under a duty to determine whether the plaintiff has a valid claim under any possible theory. * * * * For purposes of a motion to dismiss, the court must take the allegations of the complaint as true * * * and construe all reasonable inferences to be drawn from those facts in favor of the plaintiff. * * * *

C.

[¶4] A federal court sitting in diversity must be mindful that it follow the law determined by the highest court of the state whose law is applicable to resolution of the dispute. * * *
* When that state court has not directly ruled on the issue under consideration, the federal court "must make an estimate of what the state's highest court would rule to be its law."
* * * *

II.

[¶5] Because the contract between the parties was a contract for the sale of goods, the law governing this transaction is to be found in Article 2 of the Uniform Commercial Code ("UCC"); Conn.Gen.Stat. §§ 42a-2-101 et seq. In its motion to dismiss, the defendant argues that the plaintiff fails to state a claim upon which relief can be granted because the plaintiff breached the contract which provided for a delivery period of ten to twelve weeks

* The contract incorporates three writings attached to the complaint as exhibits: the seller's Quotation 5005, dated January 17, 1989; the seller's Amended Letter, dated January 24, 1989; and the buyer's final sale order, dated January 24, 1989.

from the date of the order, January 24, 1989. Since the delivery period ended on April 18, 1989, the May 4 hardware delivery was 16 days late. The defendant contends that because the plaintiff delivered the hardware after the contractual deadline, the late delivery entitled the defendant to reject delivery, since a seller is required to tender goods in conformance with the terms set forth in a contract. U.C.C. § 2-301; Conn.Gen.Stat. § 42a-2-301. * * * *

[¶6] * * * [P]laintiff argues that the defendant relies on the perfect tender rule, allowing buyers to reject for any non-conformity with the contract. Plaintiff points out that the defendant has not cited one case in which a buyer rejected goods solely because of a late delivery, and that the doctrine of "perfect tender" has been roundly criticized. While it is true that the perfect tender rule has been criticized by scholars principally because it allowed a dishonest buyer to avoid an unfavorable contract on the basis of an insubstantial defect in the seller's tender, *Ramirez v. Autosport*, 88 N.J. 277, 283-85, 440 A.2d 1345, 1348-49 (1982); *Moulton Cavity & Mold, Inc. v. Lyn-Flex Indus., Inc.*, 396 A.2d 1024, 1027 (Me.1979); *E. Peters*, *Commercial Transactions* 33-37 (1971) (even before enactment of the UCC, the perfect tender rule was in decline), the basic tender provision of the Uniform Commercial Code continued the perfect tender policy developed by the common law and embodied in the Uniform Sales Act. Section 2-601 states that with certain exceptions,* the buyer has the right to reject "if the goods or the tender of delivery fail in any respect to conform to the contract." (emphasis supplied). Conn.Gen.Stat. § 42a-2-601. The courts that have considered the issue have agreed that the perfect tender rule has survived the enactment of the Code. See, e.g., *Intermeat, Inc. v. American Poultry, Inc.*, 575 F.2d 1017, 1024 (2d Cir. 1978) ("There is no doubt that the perfect tender rule applies to measure the buyer's right of initial rejection of goods under UCC section 2-601."); *Capitol Dodge Sales, Inc. v. Northern Concrete Pipe, Inc.*, 131 Mich.App. 149, 158, 346 N.W.2d 535, 539 (1983) (adoption of 2-601 creates a perfect tender rule replacing pre-Code cases defining performance of a sales contract in terms of substantial compliance); *Texas Imports v. Allday*, 649 S.W.2d 730, 737 (Tex.App.1983) (doctrine of substantial performance is not applicable under 2-601); *Ramirez*, 440 A.2d at 1349 (before acceptance, the buyer may reject goods for any nonconformity); *Sudol v. Rudy Papa Motors*, 175 N.J.Super. 238, 240-241, 417 A.2d 1133, 1134 (1980) (section 2-601 contains perfect tender rule); see also *Bowen v. Young*, 507 S.W.2d 600, 602 (Tex.Civ.App. 1974) (where goods fail in any respect to conform to the contract the buyer may, under 2-601, reject the entire unit); *Maas v. Scoboda*, 188 Neb. 189, 193, 195 N.W.2d 491, 494 (1972) (under the UCC a buyer is given the right to reject the whole if the goods fail in any respect to conform to the contract); *Ingle v. Marked Tree Equip. Co.*, 244 Ark. 1166, 1173, 428 S.W.2d 286, 289 (1968) (a buyer may accept or reject goods which fail to conform to the contract in any respect). Similarly, courts interpreting 2-601 have strictly interpreted it to mean any

* See, e.g., sections 2-508 (seller's limited right to cure defects in tender), 2-608 (buyer's limited right to revoke acceptance) and 2-612 (buyer's limited right to reject nonconforming tender under installment contract). See also *Calamari and Perillo, Contracts*, (2d Ed.1972) at 413 n. 81 ("It has been suggested that these exceptions in fact represent a new rule, supplanting the traditional perfect tender rule in that despite 2-601, the intent of the Code is to apply the doctrine of substantial performance to sales contracts.").

nonconformity, thus excluding the doctrine of substantial performance.* *Printing Center of Texas, Inc. v. Supermind Pub. Co. Inc.*, 669 S.W.2d 779, 783 (Tex.App.1984) (the term *conform* within 2-601 authorizing the buyer to reject the whole if the goods or tender of delivery fail in any respect to conform to the contract does not mean substantial performance but complete performance); *Astor v. Boulos, Inc.*, 451 A.2d 903, 906 (Me.1982) (the generally disfavored "perfect tender rule" survives enactment of the UCC as respects a contract for sale of goods but does not control in the area of service contracts which are governed by the standard of substantial performance); *Moulton Cavity & Mold, Inc. v. Lyn-Flex Indus., Inc.*, 396 A.2d 1024, 1027-28 (1979) (holding that the doctrine of substantial performance "has no application to a contract for the sale of goods"); *Jakowski v. Carole Chevrolet, Inc.*, 180 N.J.Super. 122, 125, 433 A.2d 841, 843 (1981) (degree of nonconformity of goods is irrelevant in assessing buyer's concomitant right to reject them). These courts have thus found that the tender must be perfect in the context of the perfect tender rule in the sense that the proffered goods must conform to the contract in every respect. Connecticut, however, appears in this regard to be the exception. Indeed, in the one Connecticut case interpreting 2-601, *Franklin Quilting Co., Inc. v. Orfaly*, 1 Conn.App. 249, 251, 470 A.2d 1228, 1229 (1984), in a footnote, the Appellate Court stated that "the 'perfect tender rule' requires a substantial nonconformity to the contract before a buyer may rightfully reject the goods." *Id.* at 1229 n. 3, citing *White & Summers*, Uniform Commercial Code (2d Ed.), section 8-3 (emphasis supplied). Thus, the Connecticut Appellate Court has adopted "the White and Summers construction of 2-601 as in substance a rule that does not allow rejection for insubstantial breach such as a short delay causing no damage." *Id.* (3rd Ed.) section 8-3. See also *National Fleet Supply, Inc. v. Fairchild*, 450 N.E.2d 1015, 1019 n. 4 (Ind.App.1983) (despite UCC's apparent insistence on perfect tender, it is generally understood that rejection is not available in circumstances where the goods or delivery fail in some small respect to conform to the terms of the sales contract (citing *White and Summers*)); *McKenzie v. Alla-Ohio Coals, Inc.*, 29 U.C.C.Rep.Serv. (Callaghan) 852, 856-57 (D.D.C.1979) (there is substantial authority that where a buyer has suffered no damage, he should not be allowed to reject goods because of an insubstantial nonconformity).

[¶7] As noted above, a federal court sitting in diversity must apply the law of the highest court of the state whose law applies. Since this court has determined that Connecticut law governs, the next task is to estimate whether the Connecticut Supreme Court would affirm the doctrine of substantial nonconformity, as stated in *Orfaly*, an opinion of the Connecticut Appellate Court. When the highest state court has not spoken on an issue, the federal court must look to the inferior courts of the state and to decisions of sister courts as well as federal

* This interpretation allowing a buyer to cancel a contract for any nonconformity dates back to the common law interpretation of the perfect tender rule in the law of sales which differed from the law of contracts, which allows rescission only for material breaches. *Ramirez v. Autosport*, 88 N.J. 277, 284, 440 A.2d 1345, 1349 (1982). Thus, Judge Learned Hand stated in *Mitsubishi Goshi Kaisha v. J. Aron & Co., Inc.*, 16 F.2d 185, 186 (2d Cir.1926), that "[t]here is no room in commercial contracts for the doctrine of substantial performance." While Judge Hand wrote in a pre-UCC context, modern courts have reiterated the view that perfect tender does not require substantial performance but complete performance.

courts. As noted, the weight of authority is that the doctrine of substantial performance does not apply to the sale of goods. However, as noted by White and Summers, in none of the cases approving of perfect rather than substantial tender was the nonconformity insubstantial, such as a short delay of time where no damage is caused to the buyer. White and Summers, *Uniform Commercial Code* (3rd Ed.), section 8-3 n. 8. In the instant case, there is no claim that the goods failed to conform to the contract. Nor is there a claim that the buyer was injured by the 16-day delay. There is, however, a claim that the goods were specially made, which might affect the buyer's ability to resell. Thus Connecticut's interpretation of 2-601 so as to mitigate the harshness of the perfect tender rule reflects the consensus of scholars that the rule is harsh and needs to be mitigated.* Indeed, Summers and White state that the rule has been so "eroded" by the exceptions in the Code that "relatively little is left of it; the law would be little changed if 2-601 gave the right to reject only upon 'substantial' non-conformity," especially since the Code requires a buyer or seller to act in good faith. R. Summers and J. White, *Uniform Commercial Code* (3rd Ed. 1988), 8-3, at 357. See also *Alden Press Inc. v. Block & Co., Inc.*, 123 Ill.Dec. 26, 30, 173 Ill.App.3d 251, 527 N.E.2d 489, 493 (1988) (notwithstanding the perfect tender rule, the reasonableness of buyer's rejection of goods and whether such rejection of goods is in good faith are ultimately matters for the trier of fact); *Printing Center of Texas v. Supermind Pub. Co., Inc.*, 669 S.W.2d 779, 784 (Tex.App.1984) (if the evidence establishes any nonconformity, the buyer is entitled to reject the goods as long as it is in good faith); *Neumiller Farms, Inc. v. Cornett*, 368 So.2d 272, 275 (Ala.1979) (claim of dissatisfaction with delivery of goods so as to warrant their rejection must be made in good faith, rather than in an effort to escape a bad bargain). A rejection of goods that have been specially manufactured for an insubstantial delay where no damage is caused is arguably not in good faith.

[¶8] Although the Connecticut Supreme Court has not yet addressed the issue of substantial nonconformity, it has stated, in a precode case, *Bradford Novelty Co. v. Technomatic*, 142 Conn. 166, 170, 112 A.2d 214, 216 (1955), that although "[t]he time fixed by the parties for performance is, at law, deemed of the essence of the contract," where, as here, goods have been specially manufactured, "the time specified for delivery is less likely to be considered of the essence . . . [since] in such a situation there is a probability of delay, and the loss to the manufacturer is likely to be great if the buyer refuses to accept and pay because of noncompliance with strict performance." *Id.* But see *Marlowe v. Argentine Naval Com'n*, 808 F.2d 120, 124 (D.C.Cir.1986) (buyer within its rights to cancel a contract for 6-day delay in delivery since "time is of the essence in contracts for

* This was the concern of Karl Llewellyn, which led the Code's drafters to carve out exceptions to the perfect tender rule. See, e.g., *Leitchfield Dev't Corp. v. Clark*, 757 S.W.2d 207 (Ky. App. 1988) (perfect tender rule of UCC is modified and limited by Code language that seller has reasonable opportunity to cure improper tender); *T.W. Oil, Inc. v. Consolidated Edison Co. of New York, Inc.*, 457 N.Y.S.2d 458, 463, 57 N.Y.2d 574, 443 N.E.2d 932, 937 (1982) (seller's right to cure defective tender, Section 2-508, was intended to act as a meaningful limitation on the absolutism of the perfect tender rule under which no leeway was allowed for any imperfections.)

the sale of goods") (citing *Norrington v. Wright*, 115 U.S. 188, 203, 6 S.Ct. 12, 14, 29 L.Ed. 366 (1885) ("In the contracts of merchants, time is of the essence."))

[¶9] After reviewing the case law in Connecticut, this court finds that in cases where the nonconformity involves a delay in the delivery of specially manufactured goods, the law in Connecticut requires substantial nonconformity for a buyer's rejection under 2-601, and precludes a dismissal for failure to state a claim on the grounds that the perfect tender rule, codified at 2-601, demands complete performance. Rather, Connecticut law requires a determination at trial as to whether a 16-day delay under these facts constituted a substantial nonconformity.

CONCLUSION

For the foregoing reasons, the defendant's rule 12(b)(6) motion to dismiss this one count complaint is denied.

SO ORDERED.

Questions:

1. Any difference if the computer system had been for delivery in California?
2. Why would anyone choose anything but perfect tender?

Uniform Commercial Code §§ 2-508, 2-606, 2-608

Wayne TUCKER and Elna Tucker v. AQUA YACHT HARBOR CORP.
N.D. Miss. (1990), 749 F. Supp. 142

SENDER, Chief Judge.

[¶1] This case involves allegations that all defendants breached express and implied warranties and violated the Magnuson-Moss Warranty Act in connection with plaintiffs' purchase of a boat. Plaintiffs also allege tortious conduct on the part of defendant Aluminum Cruisers. Plaintiffs seek to revoke their acceptance of the boat and to recover its purchase price and other damages, including punitive damages from Aluminum Cruisers. This cause is now before the court on a motion for summary judgment filed solely by defendant Chrysler.

FACTS

I.

[¶2] On June 18, 1988, the Tuckers purchased a boat from Aqua Yacht in Iuka, Mississippi, for \$93,920.00, less a trade-in allowance on another boat and a cash downpayment. Aluminum Cruisers manufactured the boat itself; Chrysler manufactured and supplied the two marine engines which Aluminum Cruisers installed in the boat. From Chrysler, plaintiffs received a written warranty which provided that the engines would be free "from defects in material and workmanship under normal use and service" for one year or three hundred hours, whichever occurred first. During the warranty period, Chrysler expressly agreed to repair or replace at its factory or its authorized repair facility any part or parts of such products returned to it (with transportation charges pre-paid) which its examination shall disclose to its satisfaction to have been thus defective provided it receives written notice of any such claimed defect within thirty (30) days from the date of discovery.

[¶3] The Tuckers took delivery of the boat on the date of purchase and returned to their home in Alabama. For the next seven to eight weeks, they used the boat without complaint. Then, on August 6, 1988, plaintiffs took the boat on an extended trip to Chattanooga. During the return trip, plaintiffs noticed an oil leak in the starboard engine which Mr. Tucker promptly reported to Eddie Trimble at Aqua Yacht. Mr. Trimble recommended that plaintiffs bring the boat in for repairs, but they declined to do so because the oil was "just dripping" and was, at that time, nothing to be concerned about.

[¶4] On August 22, Aqua Yacht sent two of its employees to Huntsville to examine the boat. They were unable to fix the leak, and in September, plaintiffs took the boat to Aqua Yacht's Iuka facilities. At that time, Aqua Yacht "pulled" both engines and installed new oil seals; the engines were then tested and reinstalled.

[¶5] Plaintiffs experienced no further oil leakage problems until February, 1989, when the starboard engine again began leaking oil. On February 4, Mr. Tucker informed Mr. Trimble by letter of this problem, and on February 27, plaintiffs redelivered the boat to Aqua Yacht for additional repairs. At this time, plaintiffs lodged the following complaints about the starboard engine: (1) it leaked oil, (2) it did not run smoothly, and (3) it consumed 30 percent more gas than the port engine.

[¶6] Approximately a week later, plaintiffs retrieved the boat from Aqua Yacht. Unsatisfied with the performance of the engines, Mr. Tucker again wrote Mr. Trimble, charging that "the engine is still not operating properly and something must be done about it."

[¶7] On April 25, 1989, plaintiffs noticed a drop in the oil pressure on the port engine. Because it was knocking and would not idle down, Mr. Tucker cut off the engine and

subsequently contacted Aqua Yacht. He was told to bring the boat in for repairs using only the starboard engine. On May 3, Mr. Tucker began the trip to Iuka, but, after he was approximately three miles from the dock, he heard a loud noise from the starboard engine and saw blue smoke; he returned to the dock.

[¶8] A few days later, Mr. Tucker wrote directly to Aluminum Cruisers, Aqua Yacht, and Chrysler regarding the problems with the engines. On May 10, 1989, a Mr. Humme from Chrysler contacted Mr. Tucker and assured him that the engines would be repaired or replaced, to which Mr. Tucker responded that replacement was the "only acceptable cure."

[¶9] Plaintiffs were instructed to deliver the boat to Wholesale Marine, Inc. in Huntsville. Wholesale was to remove the engines and determine the cause of the problems. Plaintiffs delivered the boat as directed, and, on May 24, Wholesale discovered that the pistons were the source of the engines' troubles. Within two days, Chrysler shipped two new engine blocks to Wholesale for installation in plaintiffs' boat. The engines arrived six days later. According to its records, Wholesale reassembled the non-defective parts on the new engine blocks on June 8, 9, 12, and 13; and on June 28, 1989, Wholesale completed the installation of the engines. However, in the interim June 15 to be exact plaintiffs commenced their suit before this court.

[¶10] Although plaintiffs had filed suit and revoked their acceptance, Mr. Tucker nevertheless carried the boat out overnight the day after the new engines were installed. On September 8, 1989, Mr. Tucker returned the boat to Aqua Yacht and left it, simply saying, "Here's the boat." He noted that the new engines "seemed to function properly"; yet, he also stated that they leaked oil during this trip, but that the oil leak was not severe enough to require him to put any oil in the engines.

II.

[¶11] In its answer to plaintiffs' complaint, Aqua Yacht cross-claimed against Chrysler and Aluminum Cruisers, contending that it was merely the retailer of the boat, and that if it were liable to the Tuckers on any theory of breach of warranty, it would be entitled to indemnity from Chrysler, as the manufacturer of the marine engines, and Aluminum Cruisers, as the manufacturer of the boat. Subsequently, Chrysler cross-claimed against Aqua Yacht, arguing that it might be entitled to indemnity from Aqua Yacht in light of the Tuckers' allegations that Aqua Yacht failed properly to repair the boat engines.

[¶12] Chrysler now seeks summary relief as to all claims asserted against it (1) in the amended complaint and (2) in Aqua Yacht's cross-claim. Chrysler argues that plaintiffs' claims for breach of express and implied warranties fail as a matter of law, and therefore, if it is absolved of such liability, then it is entitled to relief on Aqua Yacht's cross-claim for indemnity as well.

DISCUSSION

I.

[¶13] Chrysler contends that summary disposition of this case is appropriate not only because it honored each of its obligations under the express and implied warranties, but also because it was entitled to a reasonable opportunity to cure any defects in the marine engines in plaintiffs' boat. Chrysler relies on *Fitzner Pontiac-Buick-Cadillac, Inc. v. Smith*, 523 So.2d 324 (Miss. 1988) and 15 U.S.C. § 2310(e) for the proposition that a seller must be afforded a reasonable opportunity to cure any defects in goods accepted by a buyer.

[¶14] In response, plaintiffs do not refute Chrysler's argument that it was entitled to a reasonable opportunity to cure, nor could they do so under the applicable law. Rather, plaintiffs contend that the question of whether Chrysler was given a reasonable opportunity to cure is a question of fact which precludes the granting of summary judgment. Plaintiffs argue that Chrysler was afforded three opportunities to repair the boat and that "[a] jury could . . . reasonably find that Chrysler's authorized factory representative did not use reasonable means to timely repair and replace the engines."

[¶15] With these opposing positions drawn, the court is now in a position to address the only issue which is properly before the court, i.e., whether Chrysler has established as a matter of law that it was not given a reasonable opportunity to cure before plaintiffs revoked acceptance.

II.

[¶16] Plaintiffs have not sought to reject their acceptance of the boat under section 75-2-508 of the Mississippi Code but rather have attempted to revoke that acceptance under section 75-2-608. Noticeably absent from section 75-2-608 is any mention of a seller's right to cure following the buyer's revocation. Although a seller seems to have the right to cure only when the buyer rejects goods, the Mississippi Supreme Court, by analogy to 75-2-508 and as a matter of public policy, has determined that before a buyer may revoke acceptance under 75-2-608, the seller must be afforded a reasonable opportunity to cure, even though there may have been a breach of an implied warranty. *Fitzner Pontiac-Buick-Cadillac, Inc. v. Smith*, 523 So.2d 324, 325 (Miss.1988). In reaching this conclusion, the court stated:

We recognize that a strict reading of the cure provisions of Miss.Code Ann. § 75-2-508 (1972) reveals no explicit application to [a] revocation situation The law's policy of minimization of economic waste strongly supports recognition of a reasonable opportunity for cure. Though the express language of Section 75-2-508 does not apply here, cure is not excluded by Section 75-2-608.

Id. at 328 n. 1.

[¶17] Federal law also provides for a similar right of cure: an action for breach of express or implied warranty may not be brought under Magnuson-Moss "unless the person

obligated under the warranty . . . is afforded a reasonable opportunity to cure such failure to comply." 15 U.S.C. § 2310(e). See *Royal Lincoln-Mercury Sales, Inc. v. Wallace*, 415 So.2d 1024, 1027 (Miss.1982) (alleged breach of warranty can form basis of action under applicable sections of UCC and under Magnuson-Moss).

[¶18] The "reasonable opportunity to cure" language which is employed by the Mississippi Supreme Court to determine compliance with the revocation statute does not appear in the statute itself. It is the phrase expressly utilized in Magnuson-Moss, but none of these sources offers any insight into its meaning. However, the terms "reasonable time," which is used in section 75-2-508, and "seasonably," which is used in both 75-2-508 and 75-2-608, are defined: "What is a reasonable time for taking any action depends on the nature, purpose and circumstances of such action," Miss.Code Ann. § 75-1-204(2); "[a]n action is taken 'seasonably' when it is taken at or within . . . a reasonable time." *Id.* at § 75-1-204(3).

[¶19] Although the seller has a right to effect cure in the context of a buyer's revocation, that right is not boundless. *Guerdon Industries, Inc. v. Gentry*, 531 So.2d 1202, 1208 (Miss.1988). As oft quoted,

[T]he seller does not have an unlimited time for the performance of the obligation to replace and repair parts. The buyer . . . is not bound to permit the seller to tinker with the article indefinitely in the hope that it may ultimately be made to comply with the warranty.

Orange Motors of Coral Gables, Inc. v. Dade County Dairies, Inc., 258 So.2d 319, 320-21 (Fla.Dist.Ct.App.1972). See *Rester v. Morrow*, 491 So.2d 204 (Miss.1986) (quoting *Orange Motors* and stating, "There comes a time when enough is enough when a[] . . . purchaser . . . is entitled to say, 'That's all,' and revoke, notwithstanding the seller's repeated good faith efforts [to repair]").

[¶20] Plaintiffs do not rely on Mississippi law for the proposition that the law of this state requires this case to be submitted to a jury. See *Royal Lincoln*, 415 So.2d at 1027 (in applying Magnuson-Moss, whether seller has been given a reasonable opportunity to cure is fact question which is "properly left for the jury's determination under correct instructions"). Instead, they present their argument in the familiar terms of Rule 56 of the Federal Rules of Civil Procedure. In any event, this court is governed by a federal standard, and if the evidence before the court is such that a reasonable jury could not return a verdict for the nonmovant, then summary judgment is appropriate. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S.Ct. 2505, 2510, 91 L.Ed.2d 202 (1986). On summary judgment, the role of the court is to determine if there is a genuine issue for trial, i.e., whether "there is sufficient evidence favoring the nonmoving party for a jury to return a verdict for that party." *Anderson*, 477 U.S. at 249, 106 S.Ct. at 2510.

[¶21] Essentially, the basic facts are undisputed in this case: (1) on two separate occasions, Aqua Yacht tried to repair the starboard engine; (2) when both engines failed, Chrysler offered to replace the engines as Mr. Tucker requested; (3) before the engines

could be repaired by Wholesale Marine, plaintiffs instituted suit. Plaintiffs' complaint against Chrysler now seems to be not that it did not fix the engines but that it did not "timely" repair them.

[¶22] Yet, according to Mr. Tucker's own deposition testimony, there were two specific reasons why Wholesale was delayed in making the necessary repairs to the engines in question. First, Mr. Tucker stated that the water in the Huntsville area rose during June to the point that Wholesale was unable to reach plaintiffs' boat to replace the engines. In fact, for about two to three weeks, the water was so high that it was impossible for Wholesale even to travel down the road to get to the boat. Second, Mr. Tucker charged that certain necessary parts—the gaskets—were not sent with the new engine blocks, thus leading to further delay.

[¶23] In response to the motion for summary judgment, plaintiffs submit Mr. Tucker's affidavit wherein he attempts to explain how Chrysler and Wholesale Marine could have overcome these two obstacles and proceeded with the repair of his boat. Initially, Mr. Tucker proposes various ways in which Wholesale Marine could have surmounted the high water problem since "[i]t is reasonably foreseeable in the Huntsville . . . area that the Tennessee Tombigbee Waterway will experience a water level fluctuation of 20 feet during the spring months." For example, Mr. Tucker suggests that Wholesale could have "trailed" the boat to its shop and replaced the engines there, or it could have replaced the engines when the water receded in late May and early June. Next, he charges that Chrysler and Wholesale Marine did not take "any steps whatsoever in expediting receipt of the gaskets." He maintains that they could have easily procured the missing gaskets since "[t]he Chrysler Engines in this boat are quite common and the oil gaskets necessary to reassemble an engine are readily available and can be shipped anywhere across the continental United States overnight."

[¶24] Although Mr. Tucker's theories are not disingenuous, his affidavit fails to meet the basic requirement of Rule 56(e), i.e., that the affidavit be made on personal knowledge. Fed.R.Civ.P. 56(e). Mr. Tucker offers no basis, except hindsight, for his opinions regarding how Chrysler and Wholesale could have more quickly repaired the engines. He does not, for example, indicate that he made these suggestions to the appropriate persons at the time the repairs were taking place. Further, these theories were not divulged in his lengthy deposition. Consequently, the court finds that Chrysler's argument that the affidavit "is insufficient to create any issue of fact on this matter" is well taken.

[¶25] The phrase "reasonable opportunity to cure" is necessarily a flexible one, and its meaning is dependent on the facts and circumstances of each case. Even when "all justifiable inferences" are drawn in favor of the plaintiffs as the nonmoving party, *Anderson*, 477 U.S. at 255, 106 S.Ct. at 2513, the court finds that only one conclusion can be reached: Chrysler was not afforded a reasonable opportunity to cure before plaintiffs revoked acceptance. Once Wholesale Marine determined the cause of the problems with the subject engines, Chrysler shipped two new replacements. Less than twenty business

days then elapsed between the time Wholesale received the new engines and the final repairs were performed; less than ten business days elapsed before plaintiffs filed suit. No reasonable juror could conclude, under these facts and circumstances, that filing suit while repairs were ongoing afforded Chrysler a reasonable opportunity to cure.

[¶26] This is not a case in which the seller unsuccessfully attempted to repair the goods thirty times in a one-year period, *Tiger Motor Co. v. McMurtry*, 284 Ala. 283, 224 So.2d 638 (1969), or installed three successive engines in a span of ten months, *Volkswagen of America, Inc. v. Novak*, 418 So.2d 801 (Miss.1982). Rather, this is a case in which the seller was brought into court while in the process of making repairs, which by Mr. Tucker's own testimony, resulted in the proper functioning of the engines.

[¶27] Having determined that there exists no genuine issue of fact and that defendant Chrysler is entitled to judgment as a matter of law, the court finds the motion for summary judgment on both the complaint and the cross-claim is well taken and is granted.

Questions:

1. What problems do you see with the court's analysis of the affidavit?
2. Why did Tucker *really* file suit on June 15th?
3. What policy supports the court's rule?
4. What purpose does a warranty have to Tucker? To Chrysler?

Uniform Commercial Code § 2-612 & comments

Daniel HUBBARD v. UTZ QUALITY FOODS, INC.
W.D.N.Y. (1995), 903 F. Supp. 444

LARIMER, District Judge.

[¶1] This is a breach-of-contract action brought by Daniel Hubbard ("Hubbard") against UTZ Quality Foods, Inc. ("UTZ"). Hubbard is a Bath, New York potato farmer and UTZ is a Pennsylvania corporation that purchases potatoes for processing into potato chips.

[¶2] On April 20, 1992, Hubbard executed a written contract to supply UTZ with a quantity of potatoes. The contract, a two-page, form-contract prepared by UTZ, required that the potatoes comply with certain quality standards. Hubbard claims that he was ready and able to deliver the required shipments of potatoes but that UTZ wrongfully and without basis rejected his potatoes. Hubbard contends that the sample potatoes provided to UTZ complied with all the quality requirements and, therefore, he complied with all terms of the

contract. Hubbard claims that UTZ breached the contract and claims damages for the full contract price, \$68,750.

[¶3] UTZ denies Hubbard's allegations. UTZ contends that the potatoes supplied by Hubbard did not meet the quality requirements of the contract and, therefore, they were properly rejected. UTZ filed a counterclaim against Hubbard contending that he breached the contract by failing to provide the potatoes required by contract.

[¶4] The case was tried to the Court for 5 days. The Court took testimony from 13 witnesses and received numerous documents and deposition testimony in evidence. This decision constitutes my findings of fact and conclusions of law pursuant to Fed.R.Civ.P. 52.

FACTS

APRIL 20, 1992 POTATO CONTRACT.

[¶5] On April 20, 1992, Hubbard signed the two-page contract prepared by UTZ for farmers who produced potatoes for UTZ. UTZ is a large food processor in Hanover, Pennsylvania whose principal products are potato chips and other snack foods. The contract required Hubbard, beginning "approximately September 5, 1992" to ship 11,000 hundred-weight of Norwis (657) new chipping potatoes. Hubbard was to ship 2,000 to 4,000 hundred-weight per week with schedules to be arranged with UTZ. The price was \$6.25 per hundred-weight, F.O.B. New York.

[¶6] The contract provided that the potatoes must meet certain quality standards. The buyer, UTZ, was entitled to reject the potatoes if they failed to do so. The potatoes had to meet United States Department of Agriculture ("USDA") standards for No. 1 white chipping potatoes. They had to have a minimum size and be free from bruising, rotting and odors which made them inappropriate for use in the processing of potato chips.

[¶7] The principal standard at issue in this lawsuit is the color standard. UTZ did not want dark potato chips but white or light ones and, therefore, the potatoes had to be the whitest or lightest possible color. The specific paragraph in the contract relating to color reads as follows: "Color" shall be at least # 1 or # 2 on the 1978 Snack Food Association "Fry Color Chart." The Fry Color Chart is a color chart prepared by the Potato Chip/Snack Food Association which has five color designations. Color designation No. 1 is the best or lightest and the chart contains a visual depiction of potato chips with that color. The last color designation, No. 5, is the darkest reading. The contract required that the chips produced from Hubbard's potatoes must at least meet the No. 2 color designation.

CLAIMS OF THE PARTIES.

[¶8] In a nutshell, this lawsuit revolves around the color of the potato chips processed from potatoes submitted by Hubbard to UTZ. UTZ rejected all of the submitted potatoes claiming that they did not meet the required "color" standard. UTZ claims that the samples were too dark and did not meet UTZ' standards for producing white or light chips. Hubbard, on the other hand, contends that UTZ was arbitrary in its refusal to accept his potatoes and that his potatoes substantially complied with the color requirement. Hubbard contends in his pleadings that UTZ' rejection was motivated by concerns about price, not by quality. Hubbard alleges that after rejecting his potatoes, UTZ obtained similar potatoes from other sources at prices below his contract price.

[¶9] The ultimate factual issue in this case is whether the potato chips made from Hubbard's potatoes failed to meet the color specifications of the contract. In other words, was UTZ' rejection of the installments proper.

[¶10] In large part, this case turns on matters of law relating to the rights of a buyer, such as UTZ, to reject a seller's goods that are deemed to be non-conforming. The facts and the rights and obligations of the parties must be analyzed pursuant to the New York Uniform Commercial Code ("UCC").

[¶11] Before discussing the principal issue, whether UTZ wrongfully rejected Hubbard's potatoes, I will deal with several other issues raised by the parties at trial. Some are material, some are not. Based on the evidence and the reasonable inferences from that evidence, I find the following facts.

REJECTION OF HUBBARD'S POTATOES.

[¶12] Hubbard contends that he sent several sample loads of potatoes to UTZ for inspection. On or about September 22, 1992, he sent 1,000 pounds of potatoes from one of his fields to UTZ for testing. These were rejected. Hubbard thought that they looked good when he harvested them but UTZ reported that when they were processed the color was poor. Hubbard discussed this rejection with Richard P. Smith, UTZ' Potato Manager, who told Hubbard to keep sending samples.

[¶13] Thereafter, on October 1, 1992, Hubbard sent an entire truck load of potatoes to UTZ for processing under the contract. This installment consisted of 425-450 one-hundred-pound bags. Hubbard did not accompany this shipment to Pennsylvania but he was advised by telephone that none of the potatoes would be accepted due to their poor color.

[¶14] Hubbard requested that UTZ put the reasons for this rejection in writing and Smith did so in a letter dated October 1, 1992 (Ex. 404).

[¶15] Smith stated in that letter that the load had been rejected because the color (a No. 3 color designation) was unacceptable under the contract. Smith attached a photograph of the potato chips which had been processed and he returned a sample bag of those processed chips.

[¶16] Smith told Hubbard that he did not intend to cancel the entire contract but told [Hubbard] that more tests should be run on Hubbard's other fields to see if the contract could be filled with crop from those fields.

[¶17] About a week later, on October 7, Hubbard and his brother prepared a 1,000 pound load of potatoes and drove it to UTZ' facility in Pennsylvania to see if the potatoes would pass muster. Hubbard watched the chips go through UTZ' lines, and he made a video tape of some of the process. On that tape, Hubbard is heard to say that when he saw the chips being processed, they looked "better" than he thought they would. Once again, the chips were rejected, this time by an UTZ employee Kim R. DeGroft. DeGroft had been employed by UTZ for 16 years and in 1991 he was a "lead" person or supervisor in the Potato Department. He recalled that when these chips were processed, Hubbard commented that they should have been sold to Wise, a company that routinely accepted darker chips for processing. DeGroft testified that he had been inspecting potatoes for 5-6 years, and he believed Hubbard's lot was in the No. 3 color range.

[¶18] Hubbard testified that he became quite upset at this rejection, because he believed that the chips looked good enough to meet the No. 1 or No. 2 color designation. He insisted that UTZ perform an Agtron instrument reading on the chips. Although he was not allowed to witness the test, it was reported to Hubbard that the Agtron reading was 54.2, which was in the No. 3 color category, but just below the 55 designation which would have qualified as a No. 2 designation.

[¶19] After Hubbard returned from Pennsylvania, on October 8, 1992, he had a telephone conversation with Smith during which Smith told him that based on the samples, it did not appear that Hubbard's potatoes "would work" because they did not meet the contract specifications. Smith, however, told Hubbard that he could send additional samples and shipments to Pennsylvania for inspection. Smith, however, refused to arrange for the transportation but directed Hubbard to do so. Hubbard refused saying that was not the "custom" and that in the past UTZ had always sent trucks to the fields for delivery of the product. There was apparently some dispute between Smith and Hubbard as to whether Hubbard was in default on charges to certain trucking companies for other, unrelated shipments.

[¶20] After October 7, Hubbard never delivered, or caused to be delivered, any other shipments of potatoes for UTZ pursuant to the contract.

[¶21] After allegedly conversing with certain government officials, Hubbard advised UTZ by telegram that he intended to sell his potatoes on the open market and charge UTZ for the difference in price. * * * *

INCLEMENT WEATHER.

[¶22] * * * * I find as fact that the entire potato industry suffered that season because of the weather and that other farmers had their potatoes rejected by UTZ for the same reasons that Hubbard's potatoes were rejected.

VISUAL INSPECTION/AGTRON READING.

[¶23] UTZ employees Smith and DeGroft relied on their visual inspection of the processed potato chips when they rejected them. Hubbard contends that this rejection was arbitrary and unreasonable. He advances two interrelated arguments on this point. First, he contends that he took samples of the rejected chips and had them analyzed for color at two separate locations. Both tests determined that the samples for the most part exceeded the No. 3 color designation on the Fry Color Chart. This testing was done not by visual inspection but by use of an Agtron instrument. He claims that these tests demonstrate that his potatoes in fact met the contract specifications for color.

[¶24] Second, Hubbard suggests that UTZ' rejection was wrongful because it used visual inspection and not the Agtron instrument to determine color.

[¶25] An Agtron machine is a photo electric instrument that measures reflectants of light on a surface. The higher the Agtron reading, the greater the reflectants and, therefore, the lighter or brighter the item that is being measured. The Fry Color Chart contains comparable Agtron readings for each of the five color designations. For example, color designation No. 1 on the Fry Color Chart equates to an Agtron reading of 65 or higher; a color designation No. 2 equates to an Agtron reading of 55 to 64. * * * *

[¶26] Several points must be made concerning the Agtron testing issue. First of all, the contract between the parties does not specify how the chips are to be tested, visually or by machine. The contract simply requires that the chips must exceed the No. 3 color designation.

[¶27] I recognize that the contract was a "form" contract prepared by UTZ but, nevertheless, there was no evidence to suggest that either Hubbard or UTZ were unable to require that the color test be done in a certain fashion. The manner of testing was not specified. * * * *

[¶28] [Even though Hubbard had his potatoes tested on the Agtron machine, the readings experts obtained using those machines on Hubbard's potatoes marked some of the potatoes No. 3s. Moreover, the machine would sometimes give different readings on the same set

of potatoes.] These reports show that, assuming that the same sample was tested by Gould and by Cornell's experts, there is variation even when using the Agtron device. And, as mentioned, at least some of the Agtron readings support UTZ' decision to reject the potatoes.

[¶29] But aside from these internal inconsistencies, I am concerned about the reliability of the samples used in the testing. There was very little control over the samples from the time they were turned back to Hubbard until they were tested, several months later. Portions of the samples were consumed by Hubbard and his family and the rest were stored in Hubbard's parents home but with very little security or supervision. There was confusion, even at trial, as to how the samples were preserved, maintained and delivered for later testing.

[¶30] Therefore, I am not able to place much weight on either of these tests * * * . * * *

[¶31] I find as a fact that under all the circumstances that existed in the fall of 1992, it was reasonable for UTZ to rely on visual inspection when it determined whether Hubbard's installments complied with the contract.

[¶32] As mentioned, the contract did not require Agtron readings. Therefore, the contract did not prevent UTZ from using visual inspections. Second, the testimony was uncontradicted that those in the industry consistently used visual inspections when grading potatoes under contracts of this nature. Even at the trial, almost three years after the events at issue, visual inspection is still the norm. Hubbard's expert, Wilbur Gould, testified that in his view the Agtron machine was the preferred method for testing, but he conceded that visual inspection is used in the industry. Some processors did not wish to incur the \$20,000 cost of obtaining an Agtron machine and so visual inspections persist.

[¶33] Furthermore, both Smith, UTZ' Potato Manager, and Jack Corriere, UTZ' General Manager, testified that the first Agtron machine obtained by UTZ was in October 1992, and that it was not properly calibrated and used until late October 1992, well after Hubbard's potatoes had been rejected. Both Smith and Corriere testified that visual inspection of chips was the standard in the industry at the time Hubbard presented his potatoes for inspection. Hubbard presented no evidence to contradict that testimony. Smith testified that he had been potato manager for UTZ for over 30 years and during that time he relied on visual inspection and his expertise to determine whether to accept or reject loads.

I credit the testimony, and I find as a fact, that in September and October 1992, visual inspection of potatoes was the standard used in the industry. I also find that plaintiff understood that his crop would be judged by the visual observations of UTZ' inspectors at the plant, since that was the standard procedure that had been used prior to 1992 when Hubbard and his father had sent potatoes to UTZ for processing.

MOTIVATION OF UTZ.

[¶34] Hubbard has also failed to convince me, by a preponderance of the evidence, that UTZ benefited by its rejection of Hubbard's potatoes. Smith and Corriere testified that they had suffered significant losses in the past when their potatoes had turned bad in storage. In 1992, UTZ took steps to see that such a disaster did not reoccur and so they were careful in their decisions to accept or reject potatoes.

[¶35] Furthermore, there is no compelling evidence that UTZ purchased potatoes at lower market prices after it rejected Hubbard's crop. On the contrary, the evidence (Ex. 39) suggests that the market price during late 1992 and early 1993 was equal to or higher than Hubbard's contract price. Hubbard has failed to convince me that UTZ' motivation for rejecting his potatoes was to obtain similar potatoes but at a reduced cost. Therefore, I find as a fact, that UTZ' reason and motivation for rejection was its belief that the potatoes failed to meet the quality standards in the contract.

DISCUSSION

UTZ' REJECTION OF HUBBARD'S POTATOES.

[¶36] The primary legal issue in this matter is whether UTZ' rejection of Hubbard's potatoes was proper or wrongful. It is clear that the transaction at issue is a sale of goods governed by the New York Uniform Commercial Code ("UCC") Article 2. Indeed, the parties have stipulated that both Hubbard and UTZ are "merchants" as defined by UCC § 2-104(3).

[¶37] It is also clear that the contract between the parties is an "installment contract" as that term is defined in UCC § 2-612(1): it contemplates "delivery of goods in separate lots to be separately accepted." That the contract is an installment contract does not appear to have been disputed by the parties. However, it is also evident as a matter of law from terms found throughout the contract.

[¶38] For instance, in paragraph 1, the contract calls for the sale of "11,000 hundred weight of new chipping potatoes . . ." to be shipped in quantities of "2,000 to 4,000 hundred weight per week" starting around September 5, 1992. This language clearly contemplates between 3 and 6 total shipments.

[¶39] Additionally, paragraphs 3(a) and 3(b) specifically note that standards must be met by "all shipments," which suggests that more than one shipment is contemplated.

[¶40] Finally, paragraph 4, concerning payment, states that "[b]uyer agrees to pay for all potatoes accepted within 30 days of acceptance. . . ." This language suggests paying per shipment, since each shipment is separately subject to inspection (and acceptance), as

indicated by paragraph 3. Clearly this is an "installment" contract as defined in UCC § 2-612(1).

[¶41] As an installment contract, the question of whether UTZ' rejection was wrongful or proper is governed by UCC § 2-612(2) and (3). UCC § 2-612(2) states that a "buyer may reject any installment which is nonconforming if the non-conformity substantially impairs the value of that installment and cannot be cured. . . ." UCC § 2-612(3) states that "whenever non-conformity or default with respect to one or more installments substantially impairs the value of the whole contract there is a breach of the whole."

[¶42] The purpose of this "substantial impairment" requirement is "to preclude a party from canceling a contract for trivial defects." *Emanuel Law Outlines, Inc. v. Multi-State Legal Studies*, 1995 WL 519999, *7, No. 93 Civ. 7212 (S.D.N.Y.1995). In this case, UTZ rejected Hubbard's potatoes based upon their failure to satisfy the color standard set forth in paragraph 3(c) of the contract. Thus, the issue for me to decide is whether the failure of Hubbard's potatoes to meet the required # 1 or # 2 color minimum constitutes a "substantial impairment" of the installments.²

[¶43] Whether goods conform to contract terms is a question of fact. See *Emanuel Law Outlines, Inc.*, *supra*, at *6 (citing *Interoil v. Apex Oil Co.*, 604 F. Supp. 978, 981 (S.D.N.Y.1985)); see also, *Processed Minerals v. AMF Tuboscope*, 123 A.D.2d 511, 507 N.Y.S.2d 102 (4th Dep't 1986). Moreover, in determining whether goods conform to contract terms, a buyer is bound by the "good faith" requirements set forth in N.Y.U.C.C. § 1-203 — "Every . . . duty within this Act imposes an obligation of good faith in its enforcement or performance." Thus, UTZ' determination that Hubbard's potatoes failed to satisfy the contract terms must have been fairly reached.

[¶44] The UTZ-Hubbard contract contains many specific requirements regarding the quality of the potatoes. In paragraph 1 the contract states that "only specified varieties as stated in contract will be accepted. . . ." Paragraph 3(a) states that

All shipments shall meet the United States Standards For Grades of Potatoes for Chipping, USDA, January 1978 . . . , in addition to other provisions enumerated in this `Section 3'. Loads that do not meet these standards may be subject to rejection (emphasis added)

Paragraph 3(b) sets forth specific size requirements (85% or better . . . graded to a 1 7/8 " minimum size); paragraph 3(c) sets forth specific gravity requirements (at least 1.070 in a standard eight pound test); paragraph 3(d) contains the color requirements at issue in this case; and paragraph 3(f) sets forth a number of other defects or incidents of improper treatment or handling of the potatoes that provide UTZ with the right to reject the potatoes.

[¶45] Clearly, the quality standards are of great importance to UTZ. They are the most detailed aspect of the contract — far more so than timing or even quantity specifications.

[¶46] In a contract of this type, where the quality standards are set forth with great specificity, the failure to satisfy one of the specifically enumerated standards is a "substantial impairment." UTZ obviously cares the most about the specific quality specifications, as is evident from the numerous references throughout the contract.

[¶47] Additionally, I find that UTZ' determination that the potatoes did not meet the required # 2 color standard was made in good faith, as required by UCC § 1-203. As noted above, the manner of visual testing utilized by UTZ was reasonable and customary. Further, Smith and DeGroft, the UTZ testers who rejected Hubbard's potatoes, provided credible testimony about their respective experience (Smith — 30 years, DeGroft — 5-6 years) and method of making such determinations. Accordingly, I find that UTZ fairly and in good faith determined that Hubbard's potatoes were nonconforming.

[¶48] Thus, I find that Hubbard's failure to meet the proper color standard amounted to a "substantial impairment" of the installments (§ 2-612(2)), substantially impairing the whole contract (§ 2-612(3)). Accordingly, I find that UTZ' rejection of Hubbard's potatoes was proper.* * * * *

CONCLUSION

[¶49] I find that plaintiff has failed to establish the claims set forth in his complaint by a preponderance of the evidence and, therefore, I find in favor of defendant on plaintiff's claims. Plaintiff's complaint is dismissed and judgment shall be entered accordingly in favor of defendant.

Defendant has failed to prove its counterclaims against plaintiff, and they are all dismissed.

IT IS SO ORDERED.

Questions:

1. What is the purpose of the "substantial non-conformity" requirement?
2. Is that perfect tender?
3. Are the comments to 2-612 any help in understanding what is going on here?

* This is not a case where UTZ has rejected the potatoes because they were a week (or a month late) or where the quantities were lower than anticipated. Such nonconformity would not constitute "substantial impairment" of this contract because timing and quantity are not its critical components. See, e.g., Emanuel, *supra*, (delay in installment shipment of bar review study aids not significant where shipment was still timely for the purposes of the contract); *Hudson Feather & Down Products, Inc. v. Lancer Clothing Corp.*, 128 A.D.2d 674, 513 N.Y.S.2d 173 (2d Dep't 1987) (delay in installment payment did not substantially impair value of whole contract).

4. Compare the definition of installment contract in section 2-612 with the test for divisibility in *Lowy*. Certainly not all divisible contracts are installment contracts, but most installment contracts are divisible.

II. Subsequent Events

Courts do not forget the exchange when examining events that happen after contract formation. Sometimes events undercut the exchange in significant ways. The four doctrines examined here—impracticability, frustration, failure of consideration, and risk of loss—preserve the bargain by allowing excuses for non-performance when certain unanticipated events render the bargain meaningless. The doctrines are contextual, however, and carefully limited so that they do not undercut the parties' exchange or the value of exchanges generally.

A. Impracticability of Performance

WADDY v. RIGGLEMAN
W.V. (2004), 606 S.E.2d 222

DAVIS, Justice

[¶1] In this case Mr. William W. Waddy, IV, (hereinafter referred to as “Mr. Waddy”), filed a law suit seeking specific performance of a contract for the sale of land. He now appeals an order of the Circuit Court of Grant County granting judgment as a matter of law in favor of the defendants, Denver L. Riggleman, III, and his wife Christine Riggleman (hereinafter referred to as “the Rigglemans”). The circuit court's award of judgment as a matter of law was based, in part, upon that court's conclusion that the Riggleman's performance of their contractual obligation should be excused as impossible because they were unable to secure certain releases to enable them to transfer clear title to Mr. Waddy as required under the relevant contract. Additionally, the circuit court concluded that time was of the essence of the contract. We find that the circuit court erred in granting judgment as a matter of law. We herein adopt the doctrine of impracticability, and further conclude that, based upon the facts established in the record at the close of Mr. Waddy's case, the Rigglemans had not met their burden of establishing that their performance had been rendered impracticable. * * * *

I.

FACTUAL AND PROCEDURAL HISTORY

[¶2] On July 5, 2002, Mr. Waddy, appellant herein and plaintiff below, entered into a contract wherein he agreed to buy a certain thirty acre tract of land from the Rigglemans, appellees herein and defendants below. It is established in the record that the Rigglemans had encountered financial difficulties and desired to sell the property in a timely fashion in order to alleviate their debt burden. Pursuant to the contract, Mr. Waddy was to pay \$750 per acre for the tract of land, for a total purchase price of \$22,500. The closing was to be held on or before September 5, 2002. In addition, the contract expressly declared, *inter alia*, that

3. Sellers agree to convey the subject real estate in fee simple, with covenants of general warranty of title, *free and clear of all liens and encumbrances*. Buyers (sic) shall have the opportunity to have a title examination done on the subject property prior to closing, and *any defects in title shall be cured by the Sellers prior to closing*.

4. Sellers agree to pay for any and all necessary costs of surveying, the preparation of the deed of conveyance, the revenue stamps, the attorney fees for any necessary releases, and all costs associated with eliminating any defects in title.

The balance of the closing expenses shall be the responsibility of the Buyer.

(Emphasis added). Mr. Waddy paid to the Rigglemans \$2,000 at the time the foregoing agreement was executed.

[¶3] The contract was prepared by Mr. John G. Ours, a lawyer in Petersburg, West Virginia (hereinafter referred to as “Attorney Ours”), who Mr. Waddy had hired to represent him in connection with this purchase of land from the Rigglemans. After Attorney Ours had been retained by Mr. Waddy, Mr. Rigglesman asked Attorney Ours to also represent the Rigglemans in this regard, including taking steps necessary to obtain releases of two deeds of trust under which the land was encumbered. Based upon representations made by Mr. Rigglesman, Attorney Ours believed he could easily obtain releases or partial releases to clear title to the thirty acre tract of land. As a result, Attorney Ours did not immediately endeavor to obtain the releases.

[¶4] [The parties made two more agreements, each time to add more land. The second agreement was executed July 29, adding ten acres at the same price per acre and on nearly identical other terms. Waddy paid another \$2,000 in downpayment and agreed to pay half the cost of the survey. The third agreement added eight more acres on nearly the same terms and extended the closing date to on or before September 20.]

[¶5] Thereafter, Mr. Rigglesman requested that the closing be held on September 16, 2002. Mr. Waddy explained that the funds he planned to use for the purchase would not be available until September 17, 2002. Mr. Rigglesman then learned that Attorney Ours had not yet obtained the releases that were necessary to clear the title to the land. Based upon

his earlier conversation with Mr. Riggleman, Attorney Ours incorrectly believed that obtaining the releases would be uncomplicated and quick to achieve.* On the contrary, there were specific requirements that had to be fulfilled before any releases would be issued by the lien holders. Attorney Ours had not secured the releases by the September 20, 2002, closing date.

[¶6] On or about September 27, 2002, after the contractually set closing date had passed, Mr. Riggleman notified Attorney Ours by letter that he would not proceed with the sale of the land to Mr. Waddy.† On October 1, 2002, Attorney Ours advised Mr. Waddy and the Rigglemans that he could no longer represent any of them.

[¶7] On November 14, 2002, Mr. Waddy instituted the civil suit underlying this appeal. Mr. Waddy sought specific performance of the contract dated September 6, 2002, for the sale of the forty-eight acres. He also sought other damages and named as party defendants the lien holders of record, who [included] * * * Chase Manhattan Mortgage Corporation * * * .

[¶8] Subsequent to the filing of Mr. Waddy's complaint, the Rigglemans conveyed a tract of real estate containing ninety-six acres to C. Fred Ours and Carol A. Ours. This conveyance purported to sever or eliminate, by failure to reserve, a right of way to the forty-eight acres that is the subject of this dispute. Consequently, Mr. Waddy filed an amended complaint naming C. Fred Ours and Carol A. Ours as party defendants. * * * *

[¶9] A bench trial was held. After Mr. Waddy presented the testimony of several witnesses and rested his case, the Rigglemans moved the circuit court to order a directed verdict. By order rendered July 7, 2003, the circuit court granted the motion for directed verdict in favor of the Rigglemans. The circuit court found that, because the dates set for closing were clearly important to the parties to the contract, the closing dates were “of the essence” with respect to the contract.‡ The circuit court also found that Mr. Waddy's ability to obtain a clear title to the real estate was a key element of the respective contracts. Observing that obtaining releases of the deeds of trust on the property by the time of closing was necessary in order to transfer clear title as contemplated by both parties, the circuit court further found that the transfer of the real estate was an impossibility.

[¶10] The circuit court dismissed the case with prejudice and ordered the Rigglemans to refund to Mr. Waddy the \$4,000 deposit made by him and \$1,200 Mr. Waddy contributed to the cost of surveying the property. The circuit court also dismissed with prejudice Mr.

* Attorney Ours testified that he did not believe that Mr. Riggleman had in any way attempted to purposefully mislead him regarding the complexity of the liens on the property. Attorney Ours also conceded that he should have begun the process of obtaining the releases at an earlier point in time.

† Mr. Riggleman apparently stated that he had obtained financial assistance from a relative and no longer needed to sell the property.

‡ The court then observed that Attorney Ours could have been more diligent in his representation of the issues of the contracts between Mr. Waddy and the Rigglemans.

Waddy's claims against the defendants C. Fred Ours and Carol A. Ours. It is from this order that Mr. Waddy now appeals.

II.

STANDARD OF REVIEW

[¶11] In this case, we are asked to review an order in which the circuit court granted to the Rigglesman's a directed verdict. Mr. Waddy correctly notes that the reference to a directed verdict is incorrect. * * * * * [W]e will treat the order before us for review as one granting a motion for judgment as a matter of law. * * * *

[¶12] In accordance with the foregoing, we now expressly hold that the appellate standard of review for a circuit court order either granting or denying a motion for judgment as a matter of law in a bench trial, made pursuant to Rule 52 of the West Virginia Rules of Civil Procedure, is de novo. On appeal, this Court, after considering the evidence in the light most favorable to the nonmovant party, will sustain the granting of a judgment as a matter of law when only one reasonable conclusion as to the verdict can be reached. But if reasonable minds could differ as to the importance and sufficiency of the evidence, a circuit court's ruling granting a directed verdict will be reversed. * * * *

III.

DISCUSSION

[¶13] Mr. Waddy raises two primary issues which will be addressed in this opinion. First, Mr. Waddy argues that the circuit court erred in granting judgment as a matter of law to the Rigglesmans on the basis that performance of the contract had been rendered impossible. Mr. Waddy next complains that the circuit court erred in concluding that time was of the essence of the contract. We will begin our analysis of this case with an overview of the doctrine of impossibility, followed by an application of the relevant doctrine to the facts of the instant case. * * * *

A. Overview of the Doctrine of Impossibility

[¶14] A statement of the doctrine of impossibility was set out by this Court in 1909 as follows: “If a party by contract charge himself with an obligation possible to be performed, he must make it good, unless performance is rendered impossible by the act of God, the law, or the other party. Unforeseen difficulties, however great, will not excuse him.” Syl. pt. 4, *McCormick v. Jordon*, 65 W. Va. 86, 63 S.E. 778 (1909). Rules such as this one announced in *McCormick* were developed in the common law to alleviate, to a limited degree, the harsh results obtained from the strict rule of absolute contractual liability by providing, under certain limited circumstances, an excuse from performance of a contract.

* * * *

[¶15] In modern times, the rule of impossibility has undergone further relaxation. As one commentator has explained:

[T]he law of impossibility has evolved through two rules. Early cases settled upon a strict rule of impossibility: parties were required, when forming their contract, to foresee, as accurately as possible, all consequences that could result from an agreement; if a contract became impossible to perform and the parties had failed to anticipate that eventuality, then the chips fell where they may, despite serious hardship to one party. Later cases moved away from this rigid viewpoint, settling on a more equitable rule of impracticability that entertained the excuse of impracticability under certain unanticipated circumstances. Substituting the term “impracticability”—instead of the historical usage of “impossibility”—better expresses the extent of the increased legal burden that is required.

30 Samuel Williston & Richard A. Lord, *A Treatise on the Law of Contracts* § 77:1, at 277 (4th ed. 2004) (footnotes omitted) (hereinafter referred to as “Williston on Contracts”).

[¶16] The modern rule, the rule of impracticability, is identified in the Restatement (Second) of Contracts as “Discharge by Supervening Impracticability,” and is described as follows:

Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.

§ 261 (1979). * * * * [A long list of citations adopting the Restatement rule omitted.]

* A companion to the rule of impracticability that is also widely recognized involves discharge by supervening frustration, and states:

Where, after a contract is made, a party's principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his remaining duties to render performance are discharged, unless the language or the circumstances indicate the contrary.

Restatement (Second) of Contracts § 265 (1979). This section of the Restatement is substantially similar to the general rule for impracticability, although it substitutes the language “principal purpose is substantially

[¶17] Following this modern trend, we now adopt the Restatement (Second) of Contracts § 261 and hold that, under the doctrine of impracticability, a party to a contract who claims that a supervening event has prevented, and thus excused, a promised performance must demonstrate each of the following: (1) the event made the performance impracticable; (2) the nonoccurrence of the event was a basic assumption on which the contract was made; (3) the impracticability resulted without the fault of the party seeking to be excused; and (4) the party has not agreed, either expressly or impliedly, to perform in spite of impracticability that would otherwise justify his nonperformance. See *O'Hara v. State*, 218 Conn. 628, 637, 590 A.2d 948, 953 * * *. See generally 2 E. Allan Farnsworth, *Farnsworth on Contracts* § 9.6, at 543-44 (1990) (“Under the new synthesis, the party that claims that a supervening event or ‘contingency’ prevented performance must meet four requirements. First, the event must have made ‘performance as agreed . . . impracticable.’ Second, the nonoccurrence of the event must have been ‘a basic assumption on which the contract was made.’ Third, the impracticability must have resulted without the fault of the party seeking to be excused. Fourth, that party must not have assumed a greater obligation than the law imposes.” (footnotes omitted)).

[¶18] Although the present rule is less strict than its inflexible ancestor, it, nevertheless, remains a difficult standard to meet. * * * *

Substituting the term ‘impracticability’—instead of the historical usage of ‘impossibility’—better expresses the extent of the increased legal burden that is required. * * * * While impracticability embraces situations short of absolute impossibility, mere increase in difficulty is not enough.
30 Williston on Contracts § 77:1, at 277-78.*

frustrated” for the language “performance is made impracticable” that is contained in § 261 of the Restatement. See 14 Corbin on Contracts § 74.2, at 15. Corbin also recognizes that

“[u]nder either doctrine, the cases turn on the degree of hardship caused by the supervening event, the foreseeability of the event, the language of the contract possibly allocating such risks, the relative fault of the parties in causing the event or failing to anticipate it, and any other circumstances indicating that one party should suffer the loss rather than the other.”

Id. (Footnotes omitted).

* Likewise, the companion rule to the rule of impracticability mentioned in the foregoing footnote, discharge by supervening frustration as set out in the Restatement (Second) of Contracts § 265, proves to be a difficult standard to meet. Indeed, Comment a to § 265 states, in relevant part:

First, the purpose that is frustrated must have been a principal purpose of that party in making the contract. It is not enough that he had in mind some specific object without which he would not have made the contract. The object must be so completely the basis of the contract that, as both parties understand, without it the transaction would make little sense. Second, the frustration must be substantial. It is not enough that the transaction has become less profitable for the affected party or even that he will sustain a loss. The frustration must be so severe that it is not fairly to be regarded as within the risks that he assumed under the contract. Third, the non-occurrence of the frustrating event must have been a basic assumption on which the contract was made.

Additionally, § 265 comports with the requirements of § 261 in that the party claiming supervening frustration may not be at fault in causing the occurrence of the events that resulted in the frustration.

B. Applying Doctrine of Impracticability to the Present Case

[¶19] Turning to the case at hand, we will now consider the doctrine of impracticability in light of the facts and lower court decision before us on appeal. Because we have herein announced a new principle of law with respect to the doctrine of impracticability, we will provide some discussion of each of the test's factors. However, because a decision on each of the factors is not necessary to our resolution of this case, and because some factors were not considered by the circuit court or addressed by the parties, we will reach conclusions only as to those factors that were addressed below.

[¶20] 1. The event made the performance impracticable. The issue of the impracticability of performance is elaborated on in Comment d to the Restatement (Second) of Contracts § 261 as follows:

Events that come within the rule stated in this Section are generally due either to “acts of God” or to acts of third parties. . . . Performance may be impracticable because extreme and unreasonable difficulty, expense, injury, or loss to one of the parties will be involved. A severe shortage of raw materials or of supplies due to war, embargo, local crop failure, unforeseen shutdown of major sources of supply, or the like, which either causes a marked increase in cost or prevents performance altogether may bring the case within the rule stated in this Section. Performance may also be impracticable because it will involve a risk of injury to person or to property, of one of the parties or of others, that is disproportionate to the ends to be attained by performance. However, “impracticability” means more than “impracticality.” A mere change in the degree of difficulty or expense due to such causes as increased wages, prices of raw materials, or costs of construction, unless well beyond the normal range, does not amount to impracticability since it is this sort of risk that a fixed-price contract is intended to cover. Furthermore, a party is expected to use reasonable efforts to surmount obstacles to performance (see § 205), and a performance is impracticable only if it is so in spite of such efforts.

(Emphasis added). It is additionally explained, in Comment e to Section 261, that:

It is sometimes said that the rule stated in this Section applies only when the performance itself is made impracticable, without regard to the particular party who is to perform. The difference has been described as that between “the thing cannot be done” and “I cannot do it,” and the former has been characterized as “objective” and the latter as “subjective.” This Section recognizes that if the performance remains practicable and it is merely beyond the party's capacity to render it, he is ordinarily not discharged, but it does not use the terms “objective” and “subjective” to express this. Instead, the rationale is that a party generally assumes the risk of his own inability to perform his duty. Even if a party contracts to render a performance that depends on some act by a third party, he is not ordinarily discharged because of a failure by that party because this is also a risk that is commonly understood to be on the obligor.

(Emphasis added) (citations omitted). As the foregoing comments demonstrate, a party relying on a defense of impracticability must show more than a mere increase in difficulty

and/or cost to be excused from performance of a contractual obligation. In addition, one seeking relief under the doctrine of impracticability must have made reasonable efforts to overcome the obstacles to performance. See *Kama Rippa Music, Inc. v. Schekeryk*, 510 F.2d 837, 842 (2d Cir.1975) (“The party pleading impossibility as a defense must demonstrate that it took virtually every action within its powers to perform its duties under the contract.” (citations omitted)).

[¶21] The circuit court explained its finding of impossibility of performance, in part, thusly:

5. On the final date for closing set by the contract of September 6, 2002, transfer of the real estate was an impossibility given the requirement of a clear title at the time of transfer of the real estate, and given that the deeds of trust on the subject real estate had not been released and could not be released on the date set for closing.

Clearly, then, the basis for the circuit court's finding of impossibility was the failure to obtain the needed releases by the closing date established by the final contract between the parties. However, we find that the circuit court's conclusion in paragraph five, that “the deeds of trust on the subject real estate . . . could not be released on the date set for closing,” does not appear to be supported by the evidence of record. At trial, Attorney Ours was the only witness to provide testimony with respect to the length of time required to obtain releases of the deeds of trust. Attorney Ours stated that it was his recollection that a representative for the holder of the first deed of trust advised him that it might take a month to obtain a release of the first lien. He explained that there were four requirements that had to be met to acquire the release. Attorney Ours testified that three of these requirements had been met in the first day. The only remaining requirement was to obtain an appraisal of the property including the forty-eight acres, and an additional appraisal establishing the property's value without the forty-eight acres.* Attorney Ours stated that he had been contacted by an appraiser hired by the Rigglemans who was seeking instruction as to exactly what he was to do. Thereafter Attorney Ours was notified that the Rigglemans did not wish to proceed with the sale, so he was not aware what ultimately transpired with respect to the appraisals or releases.

[¶22] Based upon the undisputed testimony of Attorney Ours, the evidence indicates that the releases needed to clear title could have been obtained in a month, or possibly less, given the progress that had been quickly achieved prior to the Rigglemans decision to rescind the contract. The original contract, which was prepared by Attorney Ours, was signed on July 5, 2002. Thus, two months prior to the initial closing date of September 5, and approximately two-and-one-half months prior to the final closing date of September 20, it was known that steps needed to be taken to clear the title to the land.†

* The forty-eight acres were merely a portion of a larger tract of land owned by the Rigglemans. It was the larger tract as a whole that was encumbered by the deeds of trust.

† Attorney Ours did not undertake any title research until September 8, 2002. When asked the question, “[s]o if those four things could have been done back in July, you could have potentially have made it?” Attorney

[¶23] Viewing the foregoing facts in the light most favorable to Mr. Waddy, as we are required to do, we simply cannot reach the conclusion that releases of the deeds of trust on the subject real estate could not have been obtained by the date set for closing. The evidence indicates that it was expected to take one month to obtain the releases. The Rigglemans had approximately two-and-one-half months from the date the first contract with Mr. Waddy was executed until the date set for closing. Moreover, it has been said that “[t]he mere fact that performance of a promise is made more difficult and expensive than the parties anticipated when the contract was made ordinarily will not excuse a promisor, a rule [that] is so well established that it needs no citation to authority.” 30 Williston on Contracts § 77.1, at 286.

[¶24] 2. The nonoccurrence of the event was a basic assumption on which the contract was made. The “basic assumption” factor also is discussed in the comments to section 261 of the Restatement (Second) of Contracts, where it is explained in Comment b that

[i]n order for a supervening event to discharge a duty under this Section, the non-occurrence of that event must have been a “basic assumption” on which both parties made the contract (see Introductory Note to this Chapter). This is the criterion used by Uniform Commercial Code § 2-615(a). Its application is simple enough in the cases of the death of a person or destruction of a specific thing necessary for performance. The continued existence of the person or thing (the non-occurrence of the death of [sic] destruction) is ordinarily a basic assumption on which the contract was made, so that death or destruction effects a discharge. Its application is also simple enough in the cases of market shifts or the financial inability of one of the parties. The continuation of existing market conditions and of the financial situation of the parties are ordinarily not such assumptions, so that mere market shifts or financial inability do not usually effect discharge under the rule stated in this Section. In borderline cases this criterion is sufficiently flexible to take account of factors that bear on a just allocation of risk. The fact that the event was foreseeable, or even foreseen, does not necessarily compel a conclusion that its non-occurrence was not a basic assumption. See Comment c to this Section and Comment a to § 265.

The introductory note to Chapter eleven of the Restatement (Second) of Contracts, which contains the various rules related to impracticability of performance, further states, in part:

Determining whether the non-occurrence of a particular event was or was not a basic assumption involves a judgment as to which party assumed the risk of its occurrence. In contracting for the manufacture and delivery of goods at a price fixed in the contract, for example, the seller assumes the risk of increased costs within the normal range. If, however, a disaster results in an abrupt tenfold increase in cost to the seller, a court might determine that the seller did not assume this risk by concluding that the non-occurrence of the disaster was a “basic assumption” on which the contract was made. In making such determinations, a court will look at

Ours answered: “Oh, yes. Mr. Judy, in hindsight, you know, it's a curse. I probably should have gone to the Court House within the first week, as scheduling goes, this, that and the other, I didn't.”

all circumstance, including the terms of the contract. The fact that the event was unforeseeable is significant as suggesting that its non- occurrence was a basic assumption. However, the fact that it was foreseeable, or even foreseen, does not, of itself, argue for a contrary conclusion, since the parties may not have thought it sufficiently important a risk to have made it a subject of their bargaining. Another significant factor may be the relative bargaining positions of the parties and the relative ease with which either party could have included a clause.

[¶25] Because our determination of this case is resolved by other factors in this test, and because the circuit court made no decision with respect to this particular factor, we decline to address its application to the facts at bar.

[¶26] 3. The impracticability resulted without the fault of the party seeking to be excused. The Rigglemans claim that they “did everything they could to cooperate with any requirement necessary to sell the real estate within the time of closing, and they did nothing to impede the progress of the sale of the real estate.” This is simply not borne out by the evidence contained in the record.

[¶27] Under the plain language of each of the three contracts executed between the Rigglemans and Mr. Waddy, the Rigglemans agreed “to convey the subject real estate in fee simple, with covenants of general warranty of title, free and clear of all liens and encumbrances.” They further agreed that “any defects in title shall be cured by the Sellers [the Rigglemans] prior to closing.” Finally, the Rigglemans agreed to “pay for . . . the attorney fees for any necessary releases, and all costs associated with eliminating any defects in title.” * * * Plainly, the Rigglemans contracted to accept the duty of clearing the title of all liens and encumbrances prior to closing, and of paying the costs to do so.

[¶28] With respect to the issue of fault as it relates to the doctrine of impracticability, it has been explained that,

[i]f the event that prevents the obligor's performance is caused by the obligee, it will ordinarily amount to a breach by the latter and the situation will be governed by the rules stated in Chapter 10, without regard to this Section If the event is due to the fault of the obligor himself, this Section does not apply. As used here “fault” may include not only “willful” wrongs, but such other types of conduct as that amounting to breach of contract or to negligence. . . .

Comment d, Restatement (Second) of Contracts § 261. * * * See also *Bunch v. Potter*, 123 W. Va. 528, 532, 17 S.E.2d 438, 440 (1941) (“It is the duty of contracting parties to provide against contingencies, as they are presumed to know whether the completion of the duty they undertake be within their power.” (citation omitted)). Moreover,

[w]hatever meaning is given to the term “[impracticability],” whether it be objective or subjective, and even though it be used to include varying degrees of difficulty and expense, courts usually hold that the supervening event does not excuse a promisor from the contractual duty if the promisor willfully brought about the supervening event, or if the promisor could have

foreseen and avoided it by the exercise of reasonable diligence. When one makes a contractual promise, the legal duty thereby created implies at least a reasonable degree of effort and diligence. If the exercise of such diligence would have resulted in performance, the promisor cannot say that performance was prevented by supervening impossibility. It was prevented by the promisor's own willful or negligent conduct or omission. Performance may have eventually become impossible, but the promisor is responsible for causing the impossibility.

14 Corbin on Contracts § 74.16, at 98 (footnote omitted). Thus, the fact that the Rigglemans delayed in seeking the releases may not be used by them as an excuse for nonperformance. A party cannot by its own act place itself in a position to be unable to perform a contract, then plead that inability to perform as an excuse for nonperformance. * * * * A party pleading impossibility as a defense must demonstrate that it took virtually every action within its powers to perform its duties under the contract. *Matter of Financial Corp.*, 17 B.R. 497, 504 (Bankr. W.D. Mo. 1981).

Farmers' Elec. Coop., Inc. v. Missouri Dep't of Corr., 977 S.W.2d 266, 271 (Mo. 1998) (per curiam).

[¶29] To the extent that the Rigglemans, by their assertion that they “did everything they could to cooperate with any requirement necessary to sell the real estate within the time of closing, and they did nothing to impede the progress of the sale of the real estate,” may be attempting to cast blame upon another for their failure to perform their contractual duty, we are not persuaded. “Even if a party contracts to render a performance that depends on some act by a third party, he is not ordinarily discharged because of a failure by that party because this is also a risk that is commonly understood to be on the obligor.” Comment e, Restatement (Second) of Contracts § 261.

[¶30] Because the evidence of record tends to indicate that the inability to obtain the needed releases was brought about by the Rigglemans' own neglect, we find the circuit court erred in granting judgment as a matter of law in their favor.

[¶31] 4. Performance in Spite of Impracticability. This fourth element recognizes that a party may agree to perform a duty notwithstanding that some event has rendered performance impracticable. The Restatement explains this concept thusly:

A party may, by appropriate language, agree to perform in spite of impracticability that would otherwise justify his non- performance under the rule stated in this Section. He can then be held liable for damages although he cannot perform. Even absent an express agreement, a court may decide, after considering all the circumstances, that a party impliedly assumed such a greater obligation. In this respect the rule stated in this Section parallels that of Uniform Commercial Code § 2- 615, which applies “Except so far as a seller may have assumed a greater obligation” Circumstances relevant in deciding whether a party has assumed a greater obligation include his ability to have inserted a provision in the contract

expressly shifting the risk of impracticability to the other party. This will depend on the extent to which the agreement was standardized (cf. § 211), the degree to which the other party supplied the terms (cf. § 206), and, in the case of a particular trade or other group, the frequency with which language so allocating the risk is used in that trade or group (cf. § 219). . . . If the supervening event was not reasonably foreseeable when the contract was made, the party claiming discharge can hardly be expected to have provided against its occurrence. However, if it was reasonably foreseeable, or even foreseen, the opposite conclusion does not necessarily follow. Factors such as the practical difficulty of reaching agreement on the myriad of conceivable terms of a complex agreement may excuse a failure to deal with improbable contingencies. See Comment b to this Section and Comment a to § 265.

Comment c, Restatement (Second) of Contracts § 261. Likewise, another commentator has stated,

If a party expressly undertakes to perform, even though performance becomes impracticable, impracticability will not be an excuse, and the party will be liable for damages for nonperformance. Even absent an express assumption of a greater obligation, a court may find, by negative implication from a clause excusing a party on the occurrence of some specified events, that the party assumed the risk of some other event. Furthermore, the surrounding circumstances will sometimes justify an inference that a party assumed the risk of impracticability. For example, a manufacturer that has contracted with the government to produce a product by means of a technological breakthrough has generally been held to have assumed the risk that achieving it may be impracticable. . . .

It is sometimes said that if an event is foreseeable, a party that makes an unqualified promise to perform necessarily assumes an obligation to perform, even if the occurrence of the event makes performance impracticable. Admittedly there are cases, as the [Uniform Commercial] Code commentary explains, “when the contingency in question is sufficiently foreshadowed at the time of contracting to be included among the business risks which are fairly to be regarded as part of the dickered term. . . .”

E. Allan Farnsworth, Farnsworth on Contracts § 9.6, at 552-54 (footnotes omitted).

[¶32] Because we have found that, as the evidence currently stands in the record, the Rigglemans have failed to establish that they should be excused from their performance of the contract, it is not necessary for us to apply this particular element of the test.

[¶33] 5. In Summary. Based upon the foregoing discussion, we find that the circuit court erred in granting judgment as a matter of law in favor of the Rigglemans. While the Rigglemans might be able to put on their own evidence establishing impracticability, proof of impracticability has not been established on the record that was before the circuit court at the close of Mr. Waddy's case. Consequently, we reverse the circuit court's grant of

judgment as a matter of law in favor of the Rigglemans, and remand this case for further proceedings.* * * * *

Questions:

1. Elements or factors—which is it? Are elements also factors? Are all factors elements?
2. This case is so long, and you don't even have an example of facts showing impracticability. Can you apply what you have learned to *Chugach Elec. Ass'n v. Northern Corp.*, 562 P.2d 1053 (AK 1977)? Here are the facts:

In 1966 Northern Corporation and Chugach Electric Association entered into a contract for the repair and protection of the upstream face of the Cooper Lake Dam. Due to circumstances not here relevant, Northern and Chugach amended the contract to provide that riprap and filter layer stone was to be quarried at the opposite end of the lake from the dam and transported across Cooper Lake to the dam site when the lake was frozen to a sufficient depth to permit the hauling of heavy loads. Northern began the ice haul method in the winter of 1966-67 but encountered serious difficulties. By the time the ice was thick enough to support hauling, there were water overflows of one to two feet in certain areas. Northern tried many routes in an attempt to find a safe crossing and made objections to Chugach about the condition of the ice, but Chugach insisted on performance. On March 11, 1967, a Euclid front end loader, which was used to clear the snow from the ice, broke through the ice and was lost. Chugach was informed of the loss but, in a letter dated March 21, again insisted on performance. On March 27, Northern was directed by Chugach to resume operations by the following morning or be held in default. Northern complied with this directive. After repeated efforts to haul the

* The circuit court also expressly based its decision on a letter dated September 27, 2003, from J. David Judy, III, as counsel for the Rigglemans, to Attorney Ours. The general purpose of the letter was to advise counsel for Mr. Waddy that the Rigglemans did not intend to go forward with the sale of the real estate. With respect to this letter, the circuit court stated:

The Court has reviewed a letter dated September 27, 2002, attached to the pleadings in this matter which was sent by counsel for the Defendants to attorney Ours setting forth the position of the Defendants as of that date, that the Defendants were considering the contracts to be null and void based upon the untimeliness of the expected releases of property, and the impossibility of closing on the date required within the contract of September 6, 2002. The Court finds that this matter should have been concluded upon the receipt of that letter dated September 27, 2002, and none of these proceedings should have gone forward after that date.

We are troubled by the circuit court's conclusions with regard to this letter. The contracts between Mr. Waddy and the Rigglemans included no provision regarding the circumstances under which the contract could be rescinded by either party. In essence, the circuit court's conclusion that "this matter should have been concluded upon the receipt of that letter dated September 27, 2002, grants to the Rigglemans a unilateral right to rescind the contract that was not bargained for by either party. This the circuit court is not entitled to do. See Syl. pt. 1, *Fraternal Order of Police, Lodge No. 69 v. City of Fairmont*, 196 W. Va. 97, 468 S.E.2d 712 (1996) ("It is not the right or province of a court to alter, pervert or destroy the clear meaning and intent of the parties as expressed in unambiguous language in their written contract or to make a new or different contract for them." (internal citations omitted)).

rock involving a number of near losses of equipment, including one small tractor, Northern stopped work on March 31, 1967. A letter, dated March 31, 1967, was sent to Chugach informing them of the suspension of all work. The stoppage of work at this time was done apparently with the approval of Chugach. Some of Northern's equipment was left at the work site.

During the summer and fall of 1967, Northern made repeated attempts to ascertain their position with respect to the subject contract; Chugach did not respond until January 8, 1968. The January 8 letter from Chugach informed Northern that:

. . . Because CEA cannot permit this work to drag on indefinitely, please take notice that, except that you commence this work and prosecute it with proper diligence so as to have hauled all rock by April 1, 1968, CEA will declare you in default under the contract and take such further steps with your surety or otherwise as may be necessary under the circumstances.

In a letter dated January 20, 1968, Northern informed Chugach they were mobilizing for a haul at Cooper Lake. The ice conditions at Cooper Lake were much improved over what they had been the previous winter. There was only a small amount of snow, the ice was frozen to what was believed to be the proper depth, and there were no overflow problems.

On February 1, 1968, Northern began hauling the rock across the ice in trucks that were only partially loaded. Two trucks broke through the ice, resulting in the death of both drivers and the loss of the trucks. Northern stopped all operations at this point and informed Chugach on February 16, 1968, that it would "make no further attempts to haul across the ice." By letter of March 28, 1968, Northern declared a termination of the contract.

In September 1968, Northern brought suit against Chugach seeking \$139,957.25 in damages, the difference between the amount it expended in attempting to perform the contract and the amount received from Chugach. Chugach counterclaimed for liquidated damages in the amount of \$28,250.

What do you think? The earlier opinion in *Northern Corp. v. Chugach Elec. Ass'n.*, 518 P.2d 76 (AK 1974), held as follows:

[¶1] The focal question is whether the amended contract was impossible of performance. The September 27, 1966 directive specified that the rock was to be transported 'across Cooper Lake to the dam site when such lake is frozen to a sufficient depth to permit heavy vehicle traffic thereon,' and the formal amendment specified that the hauling to the dam site would be done during the winter of 1966-67. It is therefore clear that the parties contemplated that the rock would be transported across the frozen lake by truck. Northern's repeated efforts to perform the contract by this method during the winter of 1966-67 and subsequently in February 1968, culminating in the tragic loss of life, abundantly support the trial court's finding that the contract was impossible of performance by this method.

[¶2] Chugach contends, however, that Northern was nevertheless bound to perform, and that it could have used means other than hauling by truck across the ice to transport the rock. The answer to Chugach's contention is that, as the trial court found, the parties contemplated that the rock would be hauled by truck once the ice froze to a sufficient depth to support the weight of the vehicles. The specification of this particular method of performance presupposed the existence of ice frozen to the requisite depth. Since this expectation of the parties was never fulfilled, and since the provisions relating to the means of performance was clearly material, Northern's duty to perform was discharged by reason of impossibility.

[¶3] There is an additional reason for our holding that Northern's duty to perform was discharged because of impossibility. It is true that in order for a defendant to prevail under the original common law doctrine of impossibility, he had to show that no one else could have performed the contract. However, this harsh rule has gradually been eroded, and the Restatement of Contracts has departed from the early common law rule by recognizing the principle of 'commercial impracticability'. Under this doctrine, a party is discharged from his contract obligations, even if it is technically possible to perform them, if the costs of performance would be so disproportionate to that reasonably contemplated by the parties as to make the contract totally impractical in a commercial sense. This principle was explicated in *Natus Corp. v. United States*, where the Court of Claims, although holding that the defense was not justified on the facts of that case, went on to explain:

In taking this position, we readily concede that the doctrine of legal impossibility does not demand a showing of actual or literal impossibility.

Removed from the strictures of the common law, 'impossibility' in its modern context has become a coat of many colors, including among its hues the point argued here-namely, impossibility predicated upon 'commercial impracticability.' This concept-which finds expression both in case law . . . and in other authorities . . . is grounded upon the assumption that in legal contemplation something is impracticable when it can only be done at an excessive and unreasonable cost. As stated in *Transatlantic Financing Corp. v. United States* . . . :

. . . The doctrine ultimately represents the ever-shifting line, drawn by courts hopefully responsive to commercial practices and mores, at which the community's interest in having contracts enforced according to their terms is outweighed by the commercial senselessness of requiring performance . . . (citations omitted).

[¶4] Sec. 465 of the Restatement also provides that a serious risk to life or health will excuse nonperformance.

[¶5] Alaska has adopted the Restatement doctrine whereby commercial impracticability may under certain circumstances justify regarding a contract as

impossible to perform. In *Merl F. Thomas Sons, Inc. v. State*, * * * * * [w]e quoted with approval Professor Williston's analysis of the concept of impossibility:

The true distinction is not between difficulty and impossibility. As has been seen, a man may contract to do what is impossible, as well as what is difficult. The important question is whether an unanticipated circumstance, the risk of which should not fairly be thrown upon the promisor, has made performance of the promise vitally different from what was reasonably to be expected (footnote omitted).

In the case before us the detailed opinion of the trial court clearly indicates that the appropriate standard was followed. There is ample evidence to support its findings that '(t)he ice haul method of transporting riprap ultimately selected was within the contemplation of the parties and was part of the basis of the agreement which ultimately resulted in amendment No. 1 in October 1966,' and that that method was not commercially feasible within the financial parameters of the contract. We affirm the court's conclusion that the contract was impossible of performance.

2. What if the person makes a contract to do something and then dies, or becomes too ill? Impracticable? Consider the following case:

George SEITZ v. MARK-O-LITE SIGN CONTRACTORS, INC.
N.J. Super. Ct. (1986), 510 A.2d 319

MILBERG, A.J.S.C.

[¶1] This is an action for breach of contract in which plaintiff, George Seitz, seeks damages from defendant, Mark-O-Lite Sign Contractors, Inc., in the amount of \$7,200.

[¶2] At trial, counsel for the parties agreed to submit the dispute to the court's determination based on the following stipulated facts:

[Seitz submitted a bid as general contractor to do renovation work on the Strand Theater. Seitz won the contract. Seitz needed a sub to do work on the Theater's neon sign marquee. Plaintiff obtained an estimate from Mark-O-Lite and later signed a contract with Mark-O-Lite for the work, for \$12,800.]

10. The contract between the parties contained a provision in paragraph (2) which reads as follows: "The Company shall not be liable for any failure in the performance of its obligation under this agreement which may result from strikes or acts of labor union, fires, floods, earthquakes, or acts of God, or other conditions or contingencies beyond its control."

11. Within a few days of the execution of the contract, defendant discovered that its expert sheet metal worker, Al Jorgenson, a diabetic, was required to enter the hospital and would be unable to work for an unknown period of time. Jorgenson was the only employee of defendant capable of performing the expert and detailed sheet metal work required.

12. Defendant advised plaintiff of the situation with its employee by telephone and on May 3, 1984, sent a letter to plaintiff returning the uncashed deposit check offering to complete any portion of the work which defendant was able to perform.

[Mark-O-Lite contacted other sign companies, but they wanted far more money to do the work than Mark-O-Lite was making from this job. Seitz eventually hired someone else to do it for \$20,000, including some additional items.]

15. The total damages claimed by plaintiff are in the amount of \$7,200, representing the difference between the City Sign Service price of \$20,000 and the price of \$12,800 stated in the contract between the parties.

Defendant asserts the defense of impossibility of performance due to the disability of its sheet metal worker, Jorgenson. Specifically, defendant urges that the illness of Jorgenson discharged its obligation of performance pursuant to paragraph 2 of the contract. Paragraph 2, commonly known as a force majeure clause, reads:

The Company shall not be liable for any failure in the performance of its obligations under this agreement which may result from strikes or acts of Labor Union, fires, floods, earthquakes, or acts of God, War or other conditions or contingencies beyond its control. [Emphasis supplied]

Defendant contends that Jorgenson's disability was a "condition or contingency beyond its control," that its obligation of performance was therefore excused under the above-quoted, exculpatory language.

[¶3] In construing broad, exculpatory language of this type, however, the courts of this State and the majority of jurisdictions invoke the rule of ejusdem generis. See *Abeles v. Adams Engineering Co.*, 64 N.J. Super. 167, 176 (App.Div.), mod. 35 N.J. 411 (1961); 17 Am. Jur.2d, Contracts, § 270 (1964). Under this principle, the catch-all language of the force majeure clause relied upon by defendant is not to be construed to its widest extent; rather, such language is to be narrowly interpreted as contemplating only events or things of the same general nature or class as those specifically enumerated. *Buono Sales, Inc. v. Chrysler Motors Corp.*, 363 F.2d 43, 47 (3 Cir.1966), cert. den. 385 U.S. 971, 87 S.Ct. 510, 17 L.Ed.2d 435 (1966); 17 Am. Jur.2d, supra, § 409; 24 P.O.F.2d at 291 (1980); see *Abeles v. Adams Engineering Co.*, supra, 64 N.J. Super. at 176.

[¶4] Jorgenson's disability does not fall into the same class as that of labor strikes, fires, floods, earthquakes or war. Nor can it be termed an "act of God." Jorgenson's condition was not the consequence of a stroke or a heart attack, either of because of its suddenness. See 1 Am. Jur.2d, Act of God, which might, in a particular case, be deemed an "act of God" § 10. Jorgenson is a diabetic. His disability—a partial amputation of his foot—was the result of the progressive aggravation of an infection, which aggravation was apparently rooted in his diabetes. Jorgenson's affliction was not sudden; indeed, his disability was a reasonably foreseeable consequence of his unfortunate malady. Hence, Jorgenson's incapacitation cannot be classed an "act of God" by any logical stretch of the term. See generally 1 Am. Jur.2d, Act of God, supra, § 3. Defendant's force majeure clause does not apply.

[¶5] It does not necessarily follow, however, that defendant is bereft of the defense of impossibility of performance; thus far, it has merely been determined that the force majeure clause is unavailing.

[¶6] There is very little, if any, recent New Jersey case law pertinent to the impossibility defense asserted herein; yet the general principles are well settled and relatively unchanged.

[¶7] The traditional rule with respect to impossibility by virtue of the death or illness of a particular person is set forth in the Restatement, Contracts, § 459 (1932):

A duty that requires for its performance action that can be rendered only by the promisor or some other particular person is discharged by his death or by such illness as makes the necessary action by him impossible or seriously injurious to his health, unless the contract indicates a contrary intention or there is contributing fault on the part of the person subject to the duty.

See generally 84 A.L.R.2d, § 8[c] at 49 (1962).

[¶8] A more modern formulation of the doctrine is found in §§ 261 and 262 of the Restatement, Contracts 2d (1981), which speak in terms of "impracticability" rather than "impossibility":

§ 261. Discharge by Supervening Impracticability

Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.

§ 262. Death or Incapacity of Persons Necessary for Performance

If the existence of a particular person is necessary for the performance of a duty, his death or such incapacity as makes performance impracticable is an event the non-occurrence of which was a basic assumption on which the contract was made.

Section 262 states a specific instance for the application of the rule stated in § 261 and, thus, is subject to the qualifications stated in that preceding section. See Comment a to § 262, *supra*.

[¶9] Regardless of which Restatement is adopted with respect to impossibility, however, the success of the defense in the particular mode asserted herein turns on a determination that the duty in question, as understood by the parties, can be performed only by a particular person. Restatement, Contracts 2d, § 459, Comment c, § 262, Comment b; see Calamari & Perillo, Contracts, § 13-6 at 489 (1977). Such has long been the governing standard in this State * * *, as well as in the majority of jurisdictions. See generally 17 Am.Jur.2d, Contracts, *supra*, § 414; 84 A.L.R.2d, *supra*, § 8[a], [c].

[¶10] Thus, it is clear from the foregoing that the primary application of the impossibility defense in the form asserted by defendant is in the area of personal service contracts, that

is, contracts which contemplate the peculiar skill or discretion of a particular person. Restatement, Contracts 2d, supra, § 262 Comment b; see *Walter E. Heller & Co. v. American Flyers Airline Corp.*, 459 F.2d 896, 901 (2 Cir.1972); see generally, 17 Am.Jur.2d, Contracts, supra, §§ 413, 414. Where, as here, the agreement is silent as to whether a particular person is or is not necessary for performance, all the circumstances will be considered to determine whether the duty, as understood by the parties, sufficiently involves elements of personal service or discretion as to require performance by a particular individual. Restatement, Contracts 2d, § 262, Comment b.

[¶11] The real question, therefore, is whether the duty of performance can be delegated to another: If the act to be performed is delegable, then the illness of the promisor or of a third person who is expected to perform the act does not excuse performance. Calamari & Perillo, supra, § 13-6 at 489; see Restatement, Contracts 2d, § 262, Comment b ("If an obligor can discharge his duty by the performance of another, his own disability will not discharge him."); Restatement, Contracts 2d, § 459, Comment c ("If a contractor without violation of duty can go abroad and perform by means of another, his death or illness will not make subsequent performance of his contract impossible."). The preceding is merely a corollary of the general rule that, for impossibility to operate as an excuse, it must be objective ("the thing cannot be done") rather than subjective ("I cannot do it"). Calamari & Perillo, supra § 13-12 at 497; see Restatement, Contracts 2d, § 261, Comment e; *Duff v. Trenton Beverage Co.*, 4 N.J. 605, 606 (1950).

[¶12] It is readily apparent from an application of the foregoing principles that defendant cannot prevail on its claim of impossibility of performance. Nothing in the language of the contract contemplates performance only by Jorgenson; nor do the circumstances demonstrate that the performance to be rendered by Jorgenson was so personal in nature, calling for a peculiar skill or special exercise of discretion, as to make it nondelegable. To be sure, the conduct of defendant—and that of plaintiff—following the advent of Jorgenson's incapacitation belies any claim of special need for his services. Defendant contacted a number of outside shops in an attempt to engage someone else to perform the sheet metal work. Defendant admitted that the sheet metal work could still be performed, albeit through someone other than Jorgenson. Cf. 13 Am.Jur.2d, Building and Construction Contracts, § 63 (A contract to build a house does not involve such a personal relation that it may not be performed by persons other than the contracting parties thereto and, therefore, is not terminated by the death of one of the parties).

[¶13] At best, defendant's claim is that of subjective impossibility which, as was previously stated, is no excuse for nonperformance. *Duff v. Trenton Beverage Co.*, supra, 4 N.J. at 606.

[¶14] Any claim by defendant that its obligation of performance should be excused, because to assume the higher cost of subcontracting the sheet metal work would have resulted in a marginal profit or even a loss, must fail. "Where one agrees to do, for a fixed

sum, a thing possible to be performed, he will not be excused or become entitled to additional compensation because unforeseen difficulties are encountered."

Questions:

1. Did Mark-O-Lite anticipatorily breach?
2. Is this case handled under a different standard than *Chugach*?

Uniform Commercial Code § 2-615

Question: Why does the statute only mention sellers, not buyers?

MAPLE FARMS, INC. v. CITY SCHOOL DISTRICT OF THE CITY OF ELMIRA,
NEW YORK
Supr. Ct. (1974), 76 Misc. 2d 1080

SWARTWOOD, J.

[¶1] This is a motion for summary judgment in an action for declaratory judgment whereby the plaintiff seeks, first, a determination that the contract wherein the plaintiff agreed to supply milk to the defendant school district at an agreed price be terminated without further liability on the grounds of legal "impossibility" or "impracticability" because of the occurrence of events not contemplated by the parties which makes performance impracticable * * * .

[¶2] We commend counsel on the quality of their briefs.

[¶3] The background of this dispute is that the price of raw milk at the farm site is and has been controlled for many years in this area by the United States Department of Agriculture through the New York-New Jersey Market Administrator. The president of the plaintiff milk dealer has for at least 10 years bid on contracts to supply milk for the defendant school district and is thoroughly conversant with prices and costs. Though the plaintiff avers that the defendant was aware of the prices of raw milk and the profit picture, the fiscal officer of the defendant denies that either the price of raw milk or the profit structure of suppliers was known or of any concern to him or the defendant. The defendant's only concern was the assurance of a steady supply of milk for the school lunch program at an agreed price on which the school's budget had to be based.

[¶4] The mandated price of raw milk has in the past fluctuated from a cost of \$6.73 cwt. in 1969 to a high of \$7.58 cwt. in 1972, or 12%, with fluctuation within a calendar year ranging from 1% to 4.5%. The plaintiff agreed to supply milk to the defendant for the

school year 1973-1974 by agreement of June 15, 1973 at a price of \$.0759 per half pint, at which time the mandated price of raw milk was \$8.03 cwt. By November of 1973 the price of raw milk had risen to \$9.31 cwt. and by December 1973 to \$9.89 cwt., an increase of 23% over the June, 1973 price. However, it should be noted that there was an increase from the low price in 1972 to the June 1973 price (date of the contract) of 9.5%. Because of considerable increase in the price of raw milk, the plaintiff, beginning in October 1973, has requested the defendant to relieve the plaintiff of its contract and to put the contract out for rebidding. The defendant has refused.

[¶5] The plaintiff spells out in detail its costs based on the June and December prices of raw milk and shows that it will sustain a loss of \$7,350.55 if it is required to continue its performance on the same volume with raw milk at the December price. Its contracts with other school districts where it is faced with the same problem will triple its total contemplated loss. * * * *

[¶6] The plaintiff goes to great lengths to spell out the cause of the substantial increase in the price of raw milk, which the plaintiff argues could not have been foreseen by the parties because it came about in large measure from the agreement of the United States to sell huge amounts of grain to Russia and to a lesser extent to unanticipated crop failures.

[¶7] The legal basis of the plaintiff's request for being relieved of the obligation under the contract award is the doctrine known variously as "impossibility of performance" and "frustration of performance" at common law and as "excuse by failure of presupposed conditions" under section 2-615 of the Uniform Commercial Code.

[¶8] The common-law rule is stated in Restatement of Law, Contracts (vol. 2, § 454) as follows: "§ 454. Definition of impossibility. In the Restatement of this Subject impossibility means not only strict impossibility but impracticability because of extreme and unreasonable difficulty, expense, injury or loss involved."

[¶9] Performance has been excused at common law where performance has become illegal (*Boer v. Garcia*, 240 N.Y. 9; *Matter of Kramer & Uchitelle*, 288 N.Y. 467; *Labaree Co. v. Crossman*, 100 App. Div. 499, *affd.* without opn. 184 N.Y. 586); where disaster wipes out the means of production (*Goddard v. Ishikawajima-Harima Heavy Inds. Co.*, 29 A.D.2d 754, *affd.* without opn. 24 N.Y.2d 842); where governmental action prevents performance (*Nitro Powder Co. v. Agency of Canadian Car & Foundry Co.*, 233 N.Y. 294; *Mawhinney v. Millbrook Woolen Mills*, 231 N.Y. 290).

[¶10] In *Mineral Park Land Co. v. Howard* (172 Cal. 289) the defendants agreed to take all the gravel from the plaintiff's land up to a certain quantity. The defendants took only half the agreed amount because the balance of the gravel was under the water level. The court relieved the defendants from the obligation to pay for the balance under water because it was not within the contemplation of the parties that the gravel under the water level would be taken and secondly because the cost of doing so would be 10 to 12 times as

expensive. The court stated the common-law rule (p. 293): "A thing is impossible in legal contemplation when it is not practicable; and a thing is impracticable when it can only be done at an excessive and unreasonable cost." (1 Beach on Contracts, sec. 216.) We do not mean to intimate that the defendants could excuse themselves by showing the existence of conditions which would make the performance of their obligation more expensive than they had anticipated, or which would entail a loss upon them. But, where the difference in cost is so great as here, and has the effect, as found, of making performance impracticable, the situation is not different from that of a total absence of earth and gravel."

[¶11] 407 E. 61st Garage v. Savoy Corp. (23 N.Y.2d 275) holds that where economic hardship alone is involved performance will not be excused. This is so even where governmental acts make performance more expensive. (Baker v. Johnson, 42 N.Y. 126; U. S. v. Wegematic Corp., 360 F.2d 674.) Existing circumstances and foreseeability also play a part in determining whether a party should be relieved of his contracts. (407 E. 61st Garage v. Savoy Corp., supra; Farlou Realty Corp. v. Woodsam Assoc., 49 N.Y.S.2d 367, affd. without opn. 268 App. Div. 975, affd. without opn. 294 N.Y. 846.)

[¶12] Section 2-615 of the Uniform Commercial Code states in part: "Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:

"(a) Delay in delivery or non-delivery in whole or in part by a seller * * * is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid."

[¶13] The Official Comment, No. 3 to that section points out that the test of impracticability is to be judged by commercial standards. Official Comment No. 4 states: "Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover. But a severe shortage of raw materials or of supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance, is within the contemplation of this section. (See *Ford & Sons, Ltd., v. Henry Leatham & Sons, Ltd.*, 21 Com. Cas. 55 (1915, K.B.D.).)"

[¶14] Official Comment No. 10 states in part that "governmental interference cannot excuse unless it truly 'supervenes' in such a manner as to be beyond the seller's assumption of risk."

[¶15] We find little authority dealing with this section based on facts that are similar to those in this case. (See, however, *Transatlantic Financing Corp. v. United States*, 363 F.2d

312; *United States v. Wegematic Corp.*, 360 F.2d 674, and *Natus Corp. v. United States*, 371 F.2d 450.)

[¶16] The Transatlantic case is somewhat analogous to the question raised here. In that case the Suez Canal was closed causing the plaintiff's ship en route to Iran to have to go around Africa to deliver its cargo of wheat. The plaintiff sought to recover the increased expense from the defendant. The court found that shipping dangers in the Suez Canal area could have been anticipated; that the risk should be allocated to the plaintiff and that the increased cost was not of such magnitude to say that it was not within the accepted degree of risk. The doctrine enunciated by section 2-615 of the Uniform Commercial Code was explained by the court (p. 315): "The doctrine ultimately represents the ever-shifting line, drawn by courts hopefully responsive to commercial practices and mores, at which the community's interest in having contracts enforced according to their terms is outweighed by the commercial senselessness of requiring performance. When the issue is raised, the court is asked to construct a condition of performance based on the changed circumstances, a process which involves at least three reasonably definable steps. First, a contingency — something unexpected — must have occurred. Second, the risk of the unexpected occurrence must not have been allocated either by agreement or by custom. Finally, occurrence of the contingency must have rendered performance commercially impracticable."

[¶17] Applying these rules to the facts here, we find that the contingency causing the increase of the price of raw milk was not totally unexpected. The price from the low point in the year 1972 to the price on the date of the award of the contract in June, 1973 had risen nearly 10% and any business man should have been aware of the general inflation in this country during the previous years and of the chance of crop failures.

[¶18] However, should we grant that the first test had been met and thus the substantial increase in price was due to the sale of wheat to Russia, poor crops and general market conditions which were unexpected contingencies, then the question of allocation of risk must be met. Here the very purpose of the contract was to guard against fluctuation of price of half pints of milk as a basis for the school budget. Surely had the price of raw milk fallen substantially, the defendant could not be excused from performance. We can reasonably assume that the plaintiff had to be aware of escalating inflation. It is chargeable with knowledge of the substantial increase of the price of raw milk from the previous year's low. It had knowledge that for many years the Department of Agriculture had established the price of raw milk and that that price varied. It nevertheless entered into this agreement with that knowledge. It did not provide in the contract any exculpatory clause to excuse it from performance in the event of a substantial rise in the price of raw milk. On these facts the risk of a substantial or abnormal increase in the price of raw milk can be allocated to the plaintiff. * * * *

[¶19] There is no precise point, though such could conceivably be reached, at which an increase in price of raw goods above the norm would be so disproportionate to the risk

assumed as to amount to "impracticality" in a commercial sense. However, we cannot say on these acts that the increase here has reached the point of "impracticality" in performance of this contract in light of the risks that we find were assumed by the plaintiff. * * * *

The plaintiff's motion is denied and the defendant is granted summary judgment dismissing the complaint.

B. Frustration of Purpose

PEOPLESOFT U.S.A., INC. v. SOFTECK, INC.
U.S. Dist. N. Cal. (2002), 227 F. Supp. 2d 1116

ORDER RE PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

HAMILTON, District Judge.

[¶1] Plaintiff's motion for summary judgment came on for hearing on September 18, 2002, before this court, the Honorable Phyllis J. Hamilton presiding. Plaintiff appeared by its counsel Stuart C. Clark, and defendant appeared by its counsel Helene E. Swanson. Having read the parties' papers and carefully considered their arguments and the relevant legal authority, and good cause appearing, the court hereby GRANTS the motion for the following reasons.

BACKGROUND

[¶2] This is a breach of contract case. Plaintiff PeopleSoft U.S.A., Inc. ("PeopleSoft"), which is based in California, designs and sells business software products. Defendant Softek, Inc. ("Softek"), which is based in Puerto Rico, provides software development services. In March 2000, the parties entered into a "Software License and Services Agreement." Pursuant to this agreement, PeopleSoft agreed to provide Softek with software, and Softek agreed to pay license and maintenance fees, which were noncancellable and nonrefundable, as well as installation and training fees. The agreement specified that the right to use PeopleSoft's software was exclusively for the purpose of facilitating the internal data processing operations of the Transportation Division of Softek's customer Policia de Puerto Rico ("Policia"—the Police Department of Puerto Rico).

[¶3] After the agreement was signed, PeopleSoft had shipped the software and billed Softek. Unfortunately, Policia decided for some reason not to use the software. Softek advised PeopleSoft of the situation, and returned the software, unopened. Softek also told PeopleSoft that while it considered Policia's decision to be a contractual violation, it "prefer[red] to avoid further controversies with the Policia and the Government of Puerto

Rico" because they were important customers for Softek's future projects. Nonetheless, PeopleSoft demanded to be paid. Softek has apparently agreed to pay \$87,931.63 of the amount in dispute, which represents charges for training expenses and airfares. However, Softek argues that it should not have to pay the \$150,000 license fee for the software it returned to PeopleSoft.

[¶4] PeopleSoft filed this action on July 23, 2001, alleging a single cause of action for breach of contract. Softek asserted 17 affirmative defenses. PeopleSoft now seeks summary judgment, arguing that the facts are undisputed regarding the existence of the contract, PeopleSoft's performance thereunder, Softek's non-performance, and damages, and that there is no triable issue with regard to any of Softek's affirmative defenses.

[¶5] Softek opposes the motion, arguing that triable issues exist with regard to the defenses of frustration of purpose, mistake, impossibility and impracticability of performance, mitigation of damages, failure of consideration, unconscionability, and also with regard to whether the contract contained an implied condition that Policia accept the software (not pled separately, but part of the frustration defense).

DISCUSSION

A. LEGAL STANDARD

[¶6] Summary judgment is appropriate when there is no genuine issue as to material facts and the moving party is entitled to judgment as a matter of law. * * * *

B. PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

[¶7] PeopleSoft argues that summary judgment should be granted on its breach of contract claim because it has established the existence of contract, performance by PeopleSoft, nonperformance by Softek, and damages. Softek does not dispute that the parties had a contract, that PeopleSoft performed, and that Softek did not. Softek contends, however, the existence of disputed issues of material fact regarding its affirmative defenses precludes summary judgment. Softek claims that it should be released from its contractual obligation to pay PeopleSoft because its own sublicensee, Policia, opted not to go forward with the purchase of the software.

1. IMPOSSIBILITY, IMPRACTICABILITY, AND FRUSTRATION OF PURPOSE

[¶8] Softek asserts, based on the language of the contract, that the purpose of the contract between PeopleSoft and Softek was for Softek to obtain software from PeopleSoft and provide it to Policia. The agreement states that Softek

shall only use the Software solely for the benefit of Policia de Puerto Rico, Transportation Division and . . . shall ensure that Policia de Puerto Rico,

Transportation Division, uses the Software solely for the internal purposes and in compliance with all the terms and conditions of [the agreement].

It further provides that Softek shall not

[d]istribute, disclose, market, rent, lease, license, or transfer to any third party any portion of the Licensed Rights [or] use the Licensed Rights other than to process internal data for Licensed Customer Policia de Puerto Rico, Transportation Division,

and shall not

[a]uthorize or permit Employees or Designates to use the Licensed Rights other than solely for internal data [for] Licensed Customer, Policia de Puerto Rico, Transportation Division.

Softek claims that when Policia decided it did not want the software, the purpose of the contract was frustrated and performance became impracticable. While performance by Softek (payment for the software) was still technically possible, Softek's reason for entering into the contract was destroyed and the performance therefore lost its value. Softek likens this case to cases in which an unforeseen event, such as a fire or a court order, makes it impossible for the purpose of the contract to be fulfilled. Softek claims that Policia's cancellation of the order could not be fairly regarded as within the risks Softek had assumed when it entered into the agreement.

[¶9] PeopleSoft responds that the defense of frustration of purpose is not available here, because Softek expressly assumed the risk of Policia's nonperformance and because its own conduct in not enforcing remedies against Policia was the cause of the situation in which it found itself. PeopleSoft cites to three provisions in the contract:

Except as otherwise provided for herein or in a Schedule, all payment obligations are noncancellable and nonrefundable.

Except for [Softek]'s obligation to pay PeopleSoft or to assume obligations for taxes, duties, and custom fees, neither party shall be liable for any failure to perform due to causes beyond its reasonable control.

[Softek] is responsible for and guarantees all payment to PeopleSoft on behalf of itself and of its customer, Policia de Puerto Rico.

Based on these three provisions, PeopleSoft contends that Softek expressly agreed to pay for the software and services, regardless of any intervening events. PeopleSoft also notes that Softek chose not to seek to enforce its agreement with Policia, based upon its own desire to preserve some sort of beneficial business relationship between itself and Policia.

[¶10] Although both the doctrine of impossibility and the doctrine of frustration of purpose developed from the commercial necessity of excusing performance in cases of extreme hardship, and although the two doctrines are somewhat similar to each other, frustration is not a form of impossibility. *Autry v. Republic Productions*, 30 Cal.2d 144, 147-49, 180 P.2d 888 (1947); *Lloyd v. Murphy*, 25 Cal.2d 48, 53, 153 P.2d 47 (1944). There is no impossibility of performance when one party has performed as agreed and all that remains for the other party to do is pay the agreed compensation. *Browne v. Fletcher*

Aviation Corp., 67 Cal.App.2d 855, 862, 155 P.2d 896 (1945). Thus, here, it is not impossible for Softek to perform, because performance consists of paying for the software.

[¶11] Softek argues that even if performance is possible, it would be extremely impracticable because the purpose of the contract has been frustrated. In applying the frustration excuse, courts look first to see whether the fundamental reason of both parties for entering into the contract has been frustrated by an unanticipated supervening circumstance, which substantially destroys the value of the performance by the party standing on the contract. *Waegemann v. Montgomery Ward & Co., Inc.*, 713 F.2d 452, 454 (9th Cir. 1983).

Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.

Rest.2d, Contracts § 261. The excuse of commercial frustration is a question of law, to be determined by the court from the facts of the case. *Glens Falls Indem. Co. v. Perscallo*, 96 Cal.App.2d 799, 802, 216 P.2d 567 (1950). To excuse nonperformance of a contract on the ground of commercial frustration, 1) the basic purpose of the contract, which has been destroyed by the supervening event, must be recognized by both parties to the contract, * * * ; 2) the event must be of a nature not reasonably to have been foreseen, * * * ; and the frustration must be so severe that it is not fairly to be regarded as within the risks that were assumed under the contract, * * * ; and 3) the value of counterperformance to the promisor seeking to be excused must be substantially or totally destroyed * * * .

[¶12] The purpose of the contract was the licensing of the software to Softek, so that it could be licensed to Policia, along with the provision of associated services. Softek did not seek to obtain software for its own use or the use of any entity other than Policia. PeopleSoft contends, however, that the parties expressly contracted with the awareness that Policia might not pay for the software, and that Softek expressly assumed the risk of this eventuality by agreeing that "all payment obligations are noncancellable and nonrefundable" and by agreeing to "guarantee all payment to PeopleSoft on behalf of itself and . . . Policia."

[¶13] Softek maintains that it was not reasonably foreseeable that Policia would fail to implement the software nor that the Puerto Rican Treasury Department would reverse its prior position and decide that Policia could not use the PeopleSoft program to interface with the Treasury Department's existing software. Softek notes that the contract expressly states that the purpose of the agreement is to provide Policia with PeopleSoft's software, and it is not reasonable to interpret the language of the contract as meaning that Softek accepted the risk that Policia would decide not to implement the software.

[¶14] "[T]he question whether a risk was foreseeable is quite distinct from the question whether it was contemplated by the parties When a risk has been contemplated and

voluntarily assumed . . . foreseeability is not an issue and the parties will be held to the bargain they made." Glenn R. Sewell Sheet Metal, Inc. v. Loverde, 70 Cal.2d 666, 676 n. 13, 75 Cal.Rptr. 889, 451 P.2d 721 (1969). The court finds that the language of the contract plainly assigns the risk of Policia's noncooperation to Softek. Thus, Softek cannot avoid liability by means of the defenses of frustration or impracticability. * * * *

CONCLUSION

In accordance with the foregoing, the court hereby GRANTS plaintiff's motion for summary judgment. This order fully adjudicates the motion listed at No. 20 on the clerk's docket for this case, and terminates the case and any pending motions.

IT IS SO ORDERED.

How does one show a basic assumption on which a contract was made? The following case addresses that question:

PIEPER, INC. v. LAND O'LAKES FARMLAND FEED, LLC
8th Cir. U.S. Ct. App. (2004), 390 F.3d 1062

[¶1] This appeal arises out of Pieper, Inc.'s (Pieper) breach of contract action against Land O'Lakes Farmland Feed, LLC (LOLFF). Pieper appeals the district court's grant of summary judgment to LOLFF on its affirmative defense of frustration of purpose. Frustrating Pieper, we affirm.

I. BACKGROUND

[¶2] Pieper and LOLFF entered into a Weaned Pig Purchase Agreement (Agreement), in which LOLFF agreed to purchase weaner pigs, i.e., weaned piglets, from Pieper. LOLFF intended to sell these pigs to third-party finishers, who would raise the pigs to market weight. Farmland Industries, Inc. (Farmland) then would buy market hogs from third-party finishers under the terms of an existing contract between Farmland and Pieper.

[¶3] Recital D of the Agreement explains LOLFF was to buy Pieper's weaner pigs only while Farmland purchased market hogs from third-party finishers:

LOLFF will purchase such pigs from [Pieper] only while its Customers have the ability to market such pigs utilizing the Farmland America's Best Pork Marketing Agreement No. 8073 dated November 14, 2000 and originally assigned to Pieper, Inc.

[¶4] In a deposition, Pieper's president, Michael Pieper (Mr. Pieper), testified the Agreement depended on Farmland's purchase of market hogs from third-party finishers:

Q: Farmland had to take the pigs in order for this whole arrangement to work [.] right?

A: Farmland had to take the pigs to make this whole agreement work.

Q: Because the hogs that were raised by [third-party finishers] had to go to Farmland. Otherwise [Pieper] would be in trouble under [its] contract [with Farmland,] right?

A: Yes, that's right. We required [LOLFF] to sell the pigs back to Farmland.

Q: And this deal was dependent upon [third-party finishers] being able to sell the market hogs to Farmland under Pieper's . . . contract [with Farmland,] right?

A: Yes.

Q: Because the hogs had to go to Farmland[,] right?

A: Yes, they had to be delivered to Farmland.

[¶5] Farmland subsequently refused to buy market hogs from third-party finishers, declining to consent to an assignment of the Pieper and Farmland contract. Without the ability to sell weaner pigs to third-party finishers for sale to Farmland, LOLFF had no reason to buy pigs from Pieper. As a result, LOLFF advised Pieper "it will no longer purchase pigs from Pieper under the [Agreement], and such Agreement shall be terminated effective immediately."

[¶6] Pieper filed suit against LOLFF, alleging LOLFF breached the Agreement by failing to buy Pieper's weaner pigs. In its answer, LOLFF asserted frustration of purpose as an affirmative defense. The parties filed cross motions for summary judgment. Pieper argued summary judgment was appropriate, because there was no genuine issue of material fact that LOLFF had breached the Agreement. LOLFF argued it was excused from performing, because its principal purpose behind the Agreement had been frustrated.

[¶7] The district court first determined LOLFF had breached the Agreement; however, the district court later granted summary judgment to LOLFF on its affirmative defense of frustration of purpose. The district court relied on Recital D and Mr. Pieper's testimony to determine LOLFF's principal purpose in entering into the Agreement. The district court determined LOLFF's principal purpose was to sell Pieper's pigs to third-party finishers who then would sell market hogs to Farmland, and the principal purpose had been frustrated by Farmland's refusal to buy market hogs from third-party finishers.

[¶8] On appeal, Pieper argues the district court erred in relying on extrinsic evidence to determine LOLFF's principal purpose in entering into the Agreement. Pieper contends (1) the Agreement is clear and unambiguous, (2) Recital D creates no legal obligation, and (3) LOLFF's primary purpose was to sell feed to third parties purchasing weaner pigs LOLFF acquired from Pieper.*

* "Always remember the distinction between contribution and commitment. Take the matter of bacon and eggs. The chicken makes a contribution. The pig makes a commitment." John Mack Carter

II. DISCUSSION

[¶9] We review de novo a district court's grant of summary judgment. * * * * When considering a motion for summary judgment, we view the evidence in the light most favorable to the nonmoving party. * * * * Summary judgment is proper if there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. * * * *

[¶10] Under Minnesota law, frustration of purpose will excuse contract performance when: "(1) [t]he party's principal purpose in making the contract is frustrated; (2) without that party's fault; (3) by the occurrence of an event, the non-occurrence of which was a basic assumption on which the contract was made." *City of Savage v. Formanek*, 459 N.W.2d 173, 176 (Minn.Ct.App.1990) (citation omitted). "The principal purpose: `must be so completely the basis of the contract that, as both parties understand, without it the transaction would make little sense.'" *Id.* (quoting Restatement (Second) of Contracts § 265, cmt. a (1981)).

[¶11] Pieper argues the district court erred in relying on Recital D and on Mr. Pieper's testimony to determine LOLFF's principal purpose behind the Agreement. Pieper contends the district court should have relied on only the operable terms of the Agreement and should have found the principal purpose of the Agreement was to merely buy and sell pigs, with LOLFF supplying feed for third parties purchasing the weaner pigs LOLFF purchased from Pieper.

[¶12] Pieper correctly notes that, under Minnesota law, recitals do not create legal obligations. *Berg v. Berg*, 201 Minn. 179, 275 N.W. 836, 841-42 (1937). However, in this case, the district court did not create any legal obligation beyond the operative provisions of the Agreement. Instead, the district court relied on extrinsic evidence to determine LOLFF's principal purpose in entering into the Agreement.

[¶13] Minnesota courts have not directly addressed the question of whether a court may rely on extrinsic evidence to determine a party's principal purpose. Without deciding the issue, the Minnesota Court of Appeals relied on extrinsic evidence to determine an employer's principal purpose in entering into an employment contract with an employee. See *Nat'l Recruiters, Inc. v. Toro Co.*, 343 N.W.2d 704, 708 (Minn.Ct.App.1984) (in applying the doctrine of frustration of purpose, the court considered testimony from a company manager explaining the company's purpose in hiring the individual was frustrated by elimination of the position).

[¶14] The use of extrinsic evidence to show a party's principal purpose first was demonstrated in *Krell v. Henry*, [1903] 2 K.B. 740 (C.A.), the landmark case on frustration of purpose. In *Krell*, the court excused a prospective tenant from his obligation to pay for a room overlooking the King's coronation route, when the King became ill and the coronation parade was cancelled. *Id.* at 740-41. The contract involved in *Krell* did not refer explicitly to the coronation, but the court nonetheless inferred the principal purpose had been frustrated. *Id.* at 754. *Krell* thus set forth the principle that a contract's purpose may be inferred from surrounding circumstances:

I think that you first have to ascertain, not necessarily from the terms of the contract, but, if required, from necessary inferences, drawn from surrounding circumstances recognised by both contracting parties, what is the substance of the contract, and then to ask the question whether that substantial contract needs for its foundation the assumption of the existence of a particular state of things.

Id. at 749.

[¶15] Relying on the principles enunciated in *Krell*, and the indirect authority from the Minnesota Court of Appeals in *National Recruiters, Inc.*, we hold the district court did not err in considering extrinsic evidence to determine LOLFF's principal purpose in entering into the Agreement. Based on the undisputed evidence outside the operative provisions of the Agreement, no doubt exists that LOLFF entered into the Agreement to sell weaner pigs to third-party finishers, who then would sell market hogs to Farmland. Recital D explicitly states LOLFF's obligation to purchase weaner pigs from Pieper depended on Farmland's purchase of market hogs from third-party finishers. Even Mr. Pieper testified the Agreement assumed Farmland would purchase market hogs from third-party finishers, and the "deal was dependent upon [third-party finishers] being able to sell the market hogs to Farmland."

[¶16] Having determined LOLFF's principal purpose in entering into the Agreement, we ask whether LOLFF's performance was excused under the doctrine of frustration of purpose. Our review of the record leads us to conclude, as a matter of law, LOLFF's purpose in buying pigs from Pieper was frustrated by Farmland's refusal to purchase market hogs from third-party finishers. Farmland's refusal completely frustrated the basic assumption upon which the Agreement was made and without which the Agreement makes no sense. Without the ability to sell the weaner pigs to third-party finishers for eventual sale to Farmland, LOLFF had no commercial reason to purchase pigs from Pieper. Additionally, Pieper did not present any evidence showing LOLFF was at fault with regard to Farmland's decision not to purchase market hogs from third-party finishers.

III. CONCLUSION

[¶17] The district court properly granted summary judgment to LOLFF, and we affirm.

Question: In *Howard v. Nicholson*, 566 S.W.2d 477 (Mo. App. 1977), Howard promised to construct a building in accordance with certain plans and specifications provided by

Honey's Int'l, Ltd. (Honey's), a chain of bridal salons. The building would not be suited for other uses. Howard had obtained the plans directly from Honey's; in fact, he had visited Honey's corporate offices several times in the hopes of landing construction contracts for Honey's salons. Prior to signing a construction contract with Howard, the Nicholsons had signed a 20-year lease with Honey's for the premises. Howard and the Nicholsons signed a construction contract on November 6, 1969, with a completion date of May 1, 1970. Howard began demolition work but did not obtain building permits until March 6. By that date, it was impossible to complete construction by May 1 in time for the 1970 bridal season. This was the date that Honey's required occupancy. In the meantime, Honey's had financial problems. It filed for bankruptcy on December 16, 1969. It appears to have completely gone out of business shortly thereafter. What frustration of purpose issues does this case raise?

CHASE PRECAST CORP. v. JOHN J. PAONESSA CO., INC.
Mass. (1991), 566 N.E.2d 603

LYNCH, J.

[¶1] This appeal raises the question whether the doctrine of frustration of purpose may be a defense in a breach of contract action in Massachusetts, and, if so, whether it excuses the defendant John J. Paonessa Company, Inc. (Paonessa), from performance.

[¶2] The claim of the plaintiff, Chase Precast Corporation (Chase), arises from the cancellation of its contracts with Paonessa to supply median barriers in a highway reconstruction project of the Commonwealth. Chase brought an action to recover its anticipated profit on the amount of median barriers called for by its supply contracts with Paonessa but not produced. Paonessa brought a cross action against the Commonwealth for indemnification in the event it should be held liable to Chase. After a jury-waived trial, a Superior Court judge ruled for Paonessa on the basis of impossibility of performance. Chase and Paonessa cross appealed. The Appeals Court affirmed, noting that the doctrine of frustration of purpose more accurately described the basis of the trial judge's decision than the doctrine of impossibility. *Chase Precast Corp. v. John J. Paonessa Co.*, 28 Mass. App. Ct. 639 (1990). We agree. We allowed Chase's application for further appellate review, and we now affirm.

[¶3] The pertinent facts are as follows. In 1982, the Commonwealth, through the Department of Public Works (department), entered into two contracts with Paonessa for resurfacing and improvements to two stretches of Route 128. Part of each contract called for replacing a grass median strip between the north and southbound lanes with concrete surfacing and precast concrete median barriers. Paonessa entered into two contracts with Chase under which Chase was to supply, in the aggregate, 25,800 linear feet of concrete median barriers according to the specifications of the department for highway construction.

The quantity and type of barriers to be supplied were specified in two purchase orders prepared by Chase.

[¶4] The highway reconstruction began in the spring of 1983. By late May, the department was receiving protests from angry residents who objected to use of the concrete median barriers and removal of the grass median strip. Paonessa and Chase became aware of the protest around June 1. On June 6, a group of about 100 citizens filed an action in the Superior Court to stop installation of the concrete median barriers and other aspects of the work. On June 7, anticipating modification by the department, Paonessa notified Chase by letter to stop producing concrete barriers for the projects. Chase did so upon receipt of the letter the following day. On June 17, the department and the citizens' group entered into a settlement which provided, in part, that no additional concrete median barriers would be installed. On June 23, the department deleted the permanent concrete median barriers item from its contracts with Paonessa.

[¶5] Before stopping production on June 8, Chase had produced approximately one-half of the concrete median barriers called for by its contracts with Paonessa, and had delivered most of them to the construction sites. Paonessa paid Chase for all that it had produced, at the contract price. Chase suffered no out-of-pocket expense as a result of cancellation of the remaining portion of barriers. * * * *

[¶6] In *Mishara Constr. Co.*, supra at 129, we called frustration of purpose a "companion rule" to the doctrine of impossibility. Both doctrines concern the effect of supervening circumstances upon the rights and duties of the parties. The difference lies in the effect of the supervening event. Under frustration, "[p]erformance remains possible but the expected value of performance to the party seeking to be excused has been destroyed by [the] fortuitous event" *Lloyd v. Murphy*, supra at 53. The principal question in both kinds of cases remains "whether an unanticipated circumstance, the risk of which should not fairly be thrown on the promisor, has made performance vitally different from what was reasonably to be expected." See *Lloyd*, supra at 54 (frustration); *Mishara Constr. Co.*, supra at 129 (impossibility). * * * *

[¶7] Th[e Restatement formulation of frustration of purpose] is nearly identical to the defense of "commercial impracticability," found in the Uniform Commercial Code, G. L. c. 106, Section 2-615 (1988 ed.),* which this court, in *Mishara Constr. Co.*, supra at 127-128, held to be consistent with the common law of contracts regarding impossibility of performance. * * * *

* That section states that performance is excused when it has been made "impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made." G. L. c. 106, Section 2-615.

[¶8] Paonessa bore no responsibility for the department's elimination of the median barriers from the projects. Therefore, whether it can rely on the defense of frustration turns on whether elimination of the barriers was a risk allocated by the contracts to Paonessa. *Mishara Constr. Co.*, supra at 129, articulates the relevant test:

"The question is, given the commercial circumstances in which the parties dealt: Was the contingency which developed one which the parties could reasonably be thought to have foreseen as a real possibility which could affect performance? Was it one of that variety of risks which the parties were tacitly assigning to the promisor by their failure to provide for it explicitly? If it was, performance will be required. If it could not be so considered, performance is excused."

[¶9] This is a question for the trier of fact. *Id.* at 127, 130. Paonessa's contracts with the department contained a standard provision allowing the department to eliminate items or portions of work found unnecessary. The purchase order agreements between Chase and Paonessa do not contain a similar provision. This difference in the contracts does not mandate the conclusion that Paonessa assumed the risk of reduction in the quantity of the barriers. It is implicit in the judge's findings that Chase knew the barriers were for department projects. The record supports the conclusion that Chase was aware of the department's power to decrease quantities of contract items. The judge found that Chase had been a supplier of median barriers to the department in the past. The provision giving the department the power to eliminate items or portions thereof was standard in its contracts. See *Standard Specifications for Highways and Bridges*, Commonwealth of Massachusetts Department of Public Works Section 4.06 (1973). The judge found that Chase had furnished materials under and was familiar with the so-called "Unit Price Philosophy" in the construction industry, whereby contract items are paid for at the contract unit price for the quantity of work actually accepted. Finally, the judge's finding that "[a]ll parties were well aware that lost profits were not an element of damage in either of the public works projects in issue" further supports the conclusion that Chase was aware of the department's power to decrease quantities, since the term prohibiting claims for anticipated profit is part of the same sentence in the standard provision as that allowing the engineer to eliminate items or portions of work.

[¶10] * * * * In this case, even if the parties were aware generally of the department's power to eliminate contract items, the judge could reasonably have concluded that they did not contemplate the cancellation for a major portion of the project of such a widely used item as concrete median barriers, and did not allocate the risk of such cancellation. * * * *

Judgment affirmed.

Questions:

1. Was performance by Paonessa impossible or impracticable?

2. Why does it matter that Chase knew Paonessa's contract with the government was subject to cancellation?

C. Failure of Consideration

The defense of failure of consideration, recognized most often with respect to negotiable instruments and regarded by many courts as a matter of general contract law, is related to the defenses of impracticability and frustration but also to breach. The materials on impracticability and frustration outlined how subsequent events can excuse the non-performance of a promise. We know also from the section on constructive conditions that failure to perform one of two bargained-for mutual promises may excuse non-performance of the other promise. Language describing "failure of consideration" is so general that the defense is broad enough to cover both kinds of excusing events. Here, for example, is language from a recent opinion; distinguishing lack of consideration, the court said,

Failure of consideration, however, occurs when, due to a supervening cause after an agreement is reached, the promised performance fails. * * * * The distinction between the two is that lack of consideration exists, if at all, immediately after the execution of the contract while failure of consideration arises because of subsequent events. * * * * Thus, failure of consideration may result as a consequence of one party's failure to perform its obligations under the agreement, resulting in the other party's failure to receive the consideration set forth in the agreement.

City of The Colony v. North Texas Mun. Water Dist., 272 S.W.3d 699, 733 (Tex. App. 2008). The key to the language's generality is the verb "fails"; thus, the phrasing of the rule allows the cause of the failure to be either breach or something else.

Here are some successful failure of consideration cases. What is the cause of the failure in each?

SCHAUFELBERGER v. MISTER SOFTEE Fla. App. (1972), 259 So.2d 175

OWEN, J.

[¶1] Appellee, the payee-holder of a promissory note made by Hoffman Company, Inc., brought this suit against appellant, as a guarantor of the note. The appeal is from an adverse final judgment entered upon a jury verdict. We reverse the judgment because the court erred in striking certain of appellant's affirmative defenses.

[¶2] Appellant, Irving A. Schaufelberger, was president of Hoffman Company, Inc., which had its place of business in Washington, D.C. Appellee, Mister Softee, Inc., a corporation with its principal offices located in New Jersey, sold Hoffman Company, Inc.,

four Mister Softee ice cream trucks for a total purchase price of approximately \$53,000. Part of the purchase price of the trucks was paid by Hoffman Company, Inc., executing and delivering its promissory note for \$10,000 payable to appellee at its offices in New Jersey. It is the guaranty of this note which is involved here. * * * *

[¶3] Some seven years after maturity this suit was filed. In his answer to the complaint, Schaufelberger set up various defenses, including among others, (1) failure of consideration for the guaranty contract * * * . On plaintiff's motion the court struck these two defenses, which order has been assigned as error and gives rise to the two points which we discuss.

[¶4] We turn first to the defense of the failure of consideration. While the answer was rather prolix, it alleged inferentially that (1) the principal contract (i.e., the note) and the contract of guaranty were part of the same transaction and supported by the same consideration, and (2) there was a partial failure of that consideration in that the ice cream trucks were delivered in a defective condition, at least one of which was returned to appellee and while in the latter's custody was totally demolished. Where the consideration for both the principal contract and the guaranty is the same, and the principal contract is divisible as this one, a partial failure of consideration is a defense on behalf of the guarantor to the extent of such failure. See 38 C.J.S. Guaranty § 27. It was error to strike this defense.

JONES v. FULLER-GARVEY CORPORATION
AK (1963), 386 P.2d 838

AREND, Justice.

[¶1] This appeal comes to us upon an agreed statement in which the parties stipulate that the point to be relied upon by the appellant is this: "Did the Lower Court error [sic], under the facts of this case, in holding that the December 3, 1960 fire and consequent destruction of the building on the leased premises, brought the landlord-tenant relationship between the parties to an end and thereby discharged Fuller-Garvey [the tenant-appellee] from its obligation to pay \$400.00 per month rent from December 1, 1960 through September 30, 1965 inclusive [the period stated representing the unexpired term under the lease]?"

[¶2] The facts * * * which we consider pertinent to the issue raised are as follows: By written lease the appellee corporation rented a nightclub from the appellant for a ten-year term commencing October 1, 1955. On November 5, 1960, the appellee, without legal justification, abandoned the premises. His rent at the time of the abandonment was paid through November, 1960. On December 3, 1960, the nightclub burned to the ground, apparently while unoccupied. The appellee let it be known that it would not move back onto the premises even if the nightclub were rebuilt. As for the appellant, he did not offer or intend to rebuild the nightclub.

[¶3] The appellant claimed that the appellee, in abandoning the nightclub, caused damage thereto in the sum of \$6,850 by removing equipment and fixtures, which belonged to the appellant, and by leaving the building open so that all the plumbing froze. In addition to the damages mentioned, the appellant also sought to recover rent at the rate of \$400 per month for the entire unexpired term. The trial court gave judgment for damages in the amount claimed but allowed nothing by way of rent.

[¶4] The record contains a copy of the lease agreement which we have examined. We find therein no acceleration clause for payment of rent in the event of some breach of the agreement by the lessee. Nor does the lease contain any provision regarding the rights and obligations of the parties in case the demised building should be destroyed by a chance fire rendering it unfit for tenancy. The lease does state that it is entered into for the purpose of conducting a nightclub. It also provides that the "lessee will use due care against fire hazards" and that, if the lessee defaults in the payment of rent or fails to perform any of the conditions and covenants of the lease, the lessor may evict the lessee, declare the lease forfeited and retain all moneys paid as rent and liquidated damages.

[¶5] The general rule at common law is that a tenant remains under the obligation to pay rent to become due in the future, notwithstanding the destruction of the leased premises, so long as any part thereof remains in existence capable of being occupied or enjoyed by him. However, by the terms of the lease its purpose was for the conducting of a nightclub; and this fact places the instant case in the well recognized exception to the general rule that when the purpose of the lease is totally frustrated by a supervening event of which the lease says nothing, the lease shall be dissolved and the parties shall be excused from their obligations thereunder.

[¶6] Appellant's counsel contends that the exception should not be applied in this case for the reason that the tenant, the appellee, had tortiously abandoned the premises and was wrongfully out of possession when the fire occurred. We cannot subscribe to such reasoning if the appellant implies or infers by it that the fire would not have occurred but for the wrongful conduct of the appellee in abandoning the building. There is no factual basis in the stipulated record of this case to support such an inference. * * * *

[¶7] Neither can we subscribe to such reasoning if the appellant means thereby that the cause of action as to the future rental payments and the damages thereon became fixed on the date of the abandonment. This would in effect be asking this court to apply the doctrine of anticipatory breach to the lease contract. If we were to consider the appellee's abandonment as an anticipatory breach of the lease contract, the appellant still could not recover damages for that future period after the fire, for evidence became available after the cause of action arose, but prior to judgment thereon, of the supervening impossibility which constituted a complete failure of consideration for all rent due in the future. The loss should rest where chance has placed it. The fire destroyed any cause of action as to anticipatory breach that the appellant had. * * * *

Judgment affirmed.

GODWIN v. COOPER
N.C. (1947), 41 S.E. 2d 734

Per Curiam.

Plaintiff declared on two checks issued by defendant and delivered to plaintiff in payment for a stock of goods and the assignment of a written lease on the store building in which the goods were housed. Defendant admitted giving the checks, but alleged as an affirmative defense that the lease was invalid, and that consequently there was a failure of consideration. However, no defects appear on the face of the lease, nor are any facts alleged in the answer which would render the lease invalid. The court below entered judgment in favor of the plaintiff on the pleadings, and on the record before us that ruling must be upheld and the judgment

Affirmed.

D. Risk of Loss

Uniform Commercial Code §§ 2-509, 2-510

PROBLEM 10: Rabbit Tools, Inc., makes tools in Rustbelt, Illinois. Coyote Manufacturing, LLC, is a custom fabricator of goods for U.S. military contractors. Its place of business is in Floydada, Texas. Coyote's projects are many and varied, and it frequently finds itself in need of new tools. It often buys from Rabbit.

a. Coyote ordered a Skurvinator model 3001 from Rabbit, the computer controlled model, for \$12,000. Coyote's purchase order, under shipping, requested that the Skurvinator be sent "F.O.B. Coyote Warehouse, Texas." Rabbit shipped the Skurvinator on a Yellow Freight truck, but the truck caught fire in Arkansas. Just after the driver escaped, the truck tumbled down a ravine and was destroyed along with the Skurvinator. Is Coyote liable for the price of the Skurvinator? Please consult UCC § 2-319 for guidance on the term "F.O.B." and § 2-709 on a buyer's liability for the price.

b. Any difference in (a) if the machine was to be shipped "F.O.B. Rabbit's plant in Rustbelt"?

c. Would either of your answers change if Rabbit could prove that, pursuant to the parties' agreement, title to the Skurvinator passed to Coyote at the time that the Skurvinator was loaded onto the Yellow Freight truck?

d. Rabbit sold a movable platform hoist that would allow goods to be lifted six meters into the air. Coyote ordered two. Rabbit said one of its own trucks was scheduled to make a delivery in Texas the next week and that there was room for the hoists on the truck; Rabbit could deliver the hoists at or near Floydada. Coyote agreed to pay a pro rata share of the

costs of the truck's trip. The hoists were loaded onto Rabbit's truck and taken from there to Texas and then dropped off after hours in Floydada at Coyote's address, where a Coyote employee signed for the delivery. The hoists sat overnight in the Coyote employee parking lot. The next morning around 4 am, one of the hoists was destroyed by a piece of shrapnel from a natural gas explosion next door to Coyote's address. Must Coyote pay Rabbit for the totaled hoist?

McKNIGHT v. BELLAMY
Ark. (1970), 449 S.W.2d 706

JONES, Justice.

[¶1] This is an appeal by John A. McKnight from a judgment of the White County Circuit Court in favor of John H. Bellamy, Jr. in a suit brought by Bellamy against McKnight for the return of the purchase price of a mare which McKnight sold and Bellamy purchased at an auction sale.

[¶2] John A. McKnight, doing business as Meadowland Quarter Horse Ranch, breeds registered quarter horses and sells them at public auction. In advance of the auction, and in preparation therefor, the history and credentials, including blood lines and descriptions of the animals to be sold, are published in catalogue, or booklet form, and the booklets are distributed among prospective purchasers of quarter horses. At an auction sale held on November 27, 1965, one of the McKnight mares to be sold was "Holiday Dandy" and as to her, the booklet stated: "1966 Sells bred to Silver Light 14,398 by Show Boy." John H. Bellamy, Jr. farms and raises quarter horses. He attended the auction on November 27, 1965, for the purpose of purchasing a brood mare, and relying on the information contained in the booklet, he bid and paid the sum of \$575 for the mare, "Holiday Dandy," believing her to be in foal by the registered stallion, "Silver Light."

[¶3] The record reveals a custom in the horse auction business, and one announced and followed by McKnight, that when a mare is sold under the representation that she had been bred, such representation conveys a reasonable assumption that the mare is pregnant or in foal. If it should develop following the sale, that a mare which has been sold as a bred mare is not actually in foal, then the purchaser has "return privileges." He may return the mare to the seller's ranch for the purpose of being rebred, and in such event, the purchaser is entitled to select any stallion on the seller's ranch to which the mare may be rebred.

[¶4] Two days after Bellamy purchased and paid for the mare, he learned that she was not in foal and on December 11, 1965, he returned her to McKnight's ranch to be rebred. Bellamy heard nothing further from the McKnight ranch until on March 8, 1966, Bellamy was advised by McKnight's ranch manager that the mare had died on March 3. Bellamy filed suit in the White County Circuit Court for damages in the loss of the mare because of McKnight's negligence and for the return of the purchase price because of breach of

warranty. The trial court, sitting as a jury, rendered judgment in favor of Bellamy for \$575. On appeal to this court McKnight relies on the following points for reversal:

"The risk of loss shifted to the buyer at the time of the sale. That there was no evidence that the appellee sustained any damages."

[¶5] Mr. McKnight contends that the Uniform Commercial Code sustains his position. He cites Ark.Stat. Ann. § 85-2-519 (Add.1961)* as authority for his first point, and § 85-2-714(2) as authority for his second. We are of the opinion that neither section is an aid to Mr. McKnight's position under the facts of this case.

[¶6] In citing § 85-2-519, Mr. McKnight quotes from § 85-2-510(1). This latter section was obviously intended and it reads as follows:

"Where a tender or delivery of goods so fails to conform to the contract as to give a right of rejection the risk of their loss remains on the seller until cure or acceptance."

When this section of the Code is applied to the facts in this case, it is in aid of affirmance, rather than reversal, of the judgment of the trial court.

[¶7] In his complaint, as amended, Bellamy alleged breach of warranty and also McKnight's negligence, as a cause of the mare's death. There was substantial evidence from which the trial court could have rendered the judgment it did on either count. There is ample evidence that Bellamy purchased the mare for a brood mare and that McKnight's agents represented the mare as being bred to Silver Light and led Bellamy to believe that the mare was in foal. The evidence is also clear that the mare was not in foal when she was purchased by Bellamy and that McKnight's agents and employees knew she was not in foal at the time she was sold to Bellamy under misleading representations.

[¶8] R. T. Nelson was an employee of McKnight in charge of the mares in pasture. Mr. Albritton was the ranch manager in charge of the entire operation, and Mr. Donald Gray was a trainer for McKnight and assisted in grooming and showing the animals at the auction sales. The only evidence that the mare purchased by Bellamy was ever bred to Silver Light, as represented in the booklets and at the sale, came from the testimony of R. T. Nelson who testified that the mare ran in the pasture with Silver Light and that he witnessed coverage on two occasions during the summer prior to the sale.

[¶9] [Yet, another employee found the mare in heat just a few days before the auction, which indicated she was not in foal. Normally, when the auction program has been printed already, this would be announced prior to the auction, but no announcement occurred at the auction of Holiday Dandy. After the auction, when Holiday Dandy was returned, she was not bred again, nor was she cared for well, and some evidence suggested this lack of care caused her death.]

* Apparently referring to § 85-2-510(1).

[¶10] In viewing the evidence in the light most favorable to the appellee, as we are required to do, there is substantial evidence in the record before us from which the court could have found a flagrant breach of an express warranty bordering on fraud in the sale of the mare in this case. The trial court would have been justified in finding that McKnight's agents represented that the mare was bred with the full knowledge and intent that buyers would assume that the mare was in foal, when as a matter of fact the mare was not in foal and the seller knew she was not in foal when the representation was made but did not reveal this knowledge at the sale. As a matter of fact the only evidence that the mare had been bred at all was the testimony of Nelson as to such pasture occurrence in the summer prior to the sale on November 27, 1965, and in the light of Mr. Gray's testimony as to the breeding cycles of open mares, it would appear incredible that McKnight's ranch manager and agents would have believed the mare in foal at the time of her sale on November 27, 1965.

[¶11] There is also substantial evidence from which the court could have found that McKnight's delay in calling a veterinarian upon learning the mare was ill, constituted negligence which was a proximate cause of the mare's death. In any event we conclude that there is substantial evidence to support the judgment of the trial court and that the judgment should be affirmed.

Affirmed.

Questions:

1. Section 2-510 uses the phrase “[w]here a tender or delivery of goods so fails to conform.” Is the breach mentioned in this case a failure to deliver or a failure to tender?
2. Section 2-510 has been criticized for muddying the clearer waters of § 2-509. Why should breach matter to risk of loss?

III. Remedies

A. Rescission

NEW YORK LIFE INS. CO. v. SISSON
W. D. Pennsylvania (1926), 19 F.2d 410

THOMSON, District Judge.

[¶1] This is a motion by the defendant, "in the nature of a demurrer," to dismiss the plaintiff's bill.

[¶2] On July 22, 1924, the plaintiff issued a policy of insurance on the life of Jacob Silverstein in the sum of \$25,000, containing a clause making the policy incontestable after two years from its date. On June 16, 1926, the plaintiff filed a bill in equity against the insured and S. A. Sisson, his committee, requesting the cancellation of the policy on the ground that the insurance had been procured by the said Silverstein by fraudulent misrepresentations and answers to questions contained in the applications for insurance filed with the company on July 16, 1924, upon the reliance of the truth of which the policy was issued. The plaintiff also asked an injunction restraining the defendants from instituting any action, either under the policy or for disability benefits, which might be claimed during the life of the insured. It was learned that the insured died the same day on which the action was instituted.

[¶3] On July 2, 1926, no administrator of the estate of the decedent having been appointed, the plaintiff took action to [have one appointed], which resulted [in the appointment of] S. A. Sisson * * * , and the plaintiff then amended its suit, designating the said administrator as defendant, filed a new bill against the present defendant, securing a restraining order similar to the one originally made, which order was made permanent following service of process.

[¶4] As grounds for the dismissal of the plaintiff's bill defendant urges: First, that the bill does not state any matter of equity or sufficient facts to entitle plaintiff to relief; second, that there is no allegation in the bill that the plaintiff returned or offered to return to the defendant, prior to the institution of the proceedings, the premiums paid by the insured on the policy; third, that it was necessary for the plaintiff to restore, or offer to restore, the said premiums before commencing suit. When the original bill was filed an order of court was made, directing the plaintiff to pay to the clerk the premiums paid by the insured, with interest to the date of the institution of suit, which was accordingly done.

[¶5] Without going into the questions involved in detail, my conclusions are as follows:

1. The insurance policy is a contract, and there can be no doubt that such contract is subject to equitable rescission and cancellation on the ground of fraud. *Harwi v. Metropolitan Life Insurance Co.* (D. C.) 297 F. 479; *Sunset Telephone & Telegraph Co. v. William* (C. C. A.) 162 F. 301, 22 L. R. A. (N. S.) 374, and many other cases.

2. Sufficient facts are averred in the bill which, if found to be true by the court, would probably sustain a decree for cancellation.

3. In an action at law, the status quo must be restored before an action will lie. There, in order that the plaintiff may have a legal remedy based upon rescission by the act of the party himself, he must restore or attempt to restore the consideration. The rescission reinvested him with the legal title to the thing for which he subsequently sues, and therefore must be conditioned upon a surrender of the thing received by him in pursuance of the transaction he thus avoids. This may be appropriately termed a legal rescission, and is the act of the party thereto.

4. In equity, by reason of the change of situation, a different rule prevails. A bill in equity is an action brought to rescind, and is not based on any idea, or on any theory, that the contract has already been rescinded, as in an action at law. Here the plaintiff sues for rescission. The plaintiff simply seeks the aid of the court to set aside and rescind the contract, and it is in no sense essential that he should previously have attempted a rescission, or should have made a tender of the thing received, to the other party. In such an action the plaintiff simply expresses a willingness to perform such conditions as the court may regard necessary to impose as proper terms upon which relief shall be granted. In case of rescission, what the plaintiff should do to reinstate the other party in statu quo as a condition for rescission is for the court to determine, having fully heard the case. This has been termed an equitable rescission, and the distinction between it and a legal rescission is perfectly plain, and has been fully recognized by the authorities. *Pomeroy*, *Equity Jurisprudence*, vol. 5, p. 4765; 9 *Corpus Juris*, p. 1215; *Plews v. Burrage* (C. C. A.) 274 F. 881; *Twin Lakes Land & Water Co. v. Dohner* (C. C. A.) 242 F. 402; and numerous authorities.

5. It might be added, in addition, that the complainant has no remedy at law, and can have none until the defendant brings its suit on the policy, and it could hardly be denied that the defense to an action, the bringing of which depends upon the will of the defendant, does not afford to the complainant that prompt and efficient relief which it has a right to claim under the bill. In a short time after the bringing of the suit, the right of action would have failed by reason of the incontestable clause in the policy.

[¶6] The motion to dismiss must therefore be overruled.

Questions:

1. What act must the party do to accomplish a legal rescission? One court wrote that the legally rescinding party “merely gives notice to the other party that he does not propose to be bound by the contract.” *Binkholder v. Carpenter*, 152 N.W.2d 593, 596 (Iowa 1967) (internal quotations omitted). What kind of legal action do you suppose the rescinding party should file after giving the notice? Another court said, “[W]here a contract is entered into between the parties, and upon proper grounds the plaintiff gives notice of rescission and offers to restore the consideration he has received, it is settled by innumerable decisions that a quasi contractual obligation arises on the part of the defendant to restore what he has received.” *Bennett v. Superior Ct.*, 21 P.2d 946, 951 (Cal. 1933). What do we normally call such an action? Is it broad enough to allow the court to determine whether the plaintiff properly rescinded and whether it now has a right to the return of the consideration? Would any other kind of action be appropriate?

2. In paragraph 5 subparagraph 5, the court says that, in this case, “the complainant has no remedy at law.” Is that true? Was it true on June 16, when this action was filed?

3. What grounds for rescission can you name? One court summarized as follows: “The grounds for rescission under California law include mistake, lack of capacity, undue influence, material failure of consideration, duress, illegality . . . and, of course, fraud.” *Merritt v. Erickson, Opinion*, 2011 WL 664770 *2 (Cal. App., Feb. 23, 2011) (internal quotations omitted). That’s a good list.

4. Some courts are not as circumspect about distinguishing legal and equitable rescission. Where law and equity is considered merged, this is understandable. For instance, *Wiseman v. First Mariner Bank*, Mem. Op., 2013 WL 5375248 *16 (D. Md., Sept. 23, 2013), claims, [T]he elements of a claim for rescission are:

- 1) That [the plaintiff] was induced into assenting to the contract as the result of fraud, negligent misrepresentation, undue influence or duress, or there was a material breach by the other party, or there was a mutual or unilateral mistake in contracting;
- 2) That he or she returned the consideration or was unconditionally willing to return to the other party both the consideration that was given and any benefits received under the contract;
- 3) That he or she exercised the right to rescind promptly and did not treat the contract as a continuing obligation; and
- 4) That he or she gave notice of the intention to rescind.

Plenty of courts claim that the party wishing rescission must act promptly whether acting at law or in equity. But are elements (2) and (4) legal or equitable?

B. Damages

1. Introduction

POTTER v. OSTER
Iowa (1988), 426 N.W.2d 148

NEUMAN, Justice.

[¶1] This is a suit in equity brought by the plaintiffs to rescind an installment land contract based on the seller's inability to convey title. The question on appeal is whether, in an era of declining land values, returning the parties to the status quo works an inequitable result. We think not. Accordingly, we affirm the district court judgment for rescission and restitution.

[¶2] The facts are largely undisputed. Because the case was tried in equity, our review is de novo. Iowa R.App.P. 4. We give weight to the findings of the trial court, particularly where the credibility of witnesses is concerned, but we are not bound thereby. Iowa R.App.P. 14(f)(7).

[¶3] The parties, though sharing a common interest in agribusiness, present a study in contrasts. We think the disparity in their background and experience is notable insofar as it bears on the equities of the transaction in issue. Plaintiff Charles Potter is a farm laborer and his wife, Sue, is a homemaker and substitute teacher. They have lived all their lives within a few miles of the real estate in question. Defendant Merrill Oster is an agricultural journalist and recognized specialist in land investment strategies. He owns Oster Communications, a multimillion dollar publishing concern devoted to furnishing farmers the latest in commodity market analysis and advice on an array of farm issues.

[¶4] In May 1978, Oster contracted with Florence Stark to purchase her 160-acre farm in Howard County, Iowa, for \$260,000 on a ten-year contract at seven percent interest. Oster then sold the homestead and nine acres to Charles and Sue Potter for \$70,000. Potters paid \$18,850 down and executed a ten-year installment contract for the balance at 8.5% interest. Oster then executed a contract with Robert Bishop for the sale of the remaining 151 acres as part of a package deal that included the sale of seventeen farms for a sum exceeding \$5.9 million.

[¶5] These back-to-back contracts collapsed like dominoes in March 1985 when Bishop failed to pay Oster and Oster failed to pay Stark the installments due on their respective contracts. Stark commenced forfeiture proceedings. Potters had paid every installment when due under their contract with Oster and had included Stark as a joint payee with Oster on their March 1, 1985, payment. But they were financially unable to exercise their right to advance the sums due on the entire 160 acres in order to preserve their interest in the

nine acres and homestead. As a result, their interest in the real estate was forfeited along with Oster's and Bishop's and they were forced to move from their home in August 1985.

[¶6] Potters then sued Oster to rescind their contract with him, claiming restitution damages for all consideration paid. Evidence at trial disclosed that prior to the forfeiture, Potters had paid principal and interest totalling \$59,886.25. They had made improvements to the residence costing \$2758.74, excluding their own labor. Pursuant to the contract, they had paid real estate taxes of \$2024.38 and insurance premiums of \$3041.46. Miscellaneous expenses for closing the transaction and relocating after forfeiture totalled \$1000. The principal balance remaining on their contract with Oster was \$27,900.

[¶7] Trial testimony also revealed that the market value of the property had decreased markedly since its purchase. Expert appraisers valued the homestead and nine acres between \$27,500 and \$35,000. Oster himself placed a \$28,000 value on the property; Potter \$39,000. Evidence was also received placing the reasonable rental value of the property at \$150 per month, or a total of \$10,800 for the six-year Potter occupancy.

[¶8] The district court concluded the Potters were entitled to rescission of the contract and return of the consideration paid including principal and interest, cost of improvements, closing expenses, and taxes for a total of \$65,169.37. From this the court deducted \$10,800 for six years' rental, bringing the final judgment to \$54,369.37.

[¶9] On appeal, Oster challenges the judgment on two grounds. First, he claims Potters had an adequate remedy at law for damages which should have been measured by the actual economic loss sustained. Second, Oster contends the trial court failed to strike an equitable balance between the parties by ignoring Potters' alleged failure to mitigate their damages.

[¶10] I. Judicial remedies for breach of contract serve to protect one or more of the following interests of the promisee:

- (a) "Expectation interest" in having the benefit of the bargain, placing the promisee in as good a position as if the contract had been fully performed;
- (b) "Reliance interest" in reimbursement for the loss caused by reliance on the contract, placing the promisee in as good a position as if the contract had not been made; or
- (c) "Restitution interest" in having restored to the promisee the benefit conferred upon the party in breach.

See Restatement (Second) of Contracts § 344 (1979); see also E. Farnsworth, Contracts § 12.1, at 811-15 (1982) (hereafter Farnsworth).

[¶11] Each remedy tailors the reimbursement to the loss sustained. Recovery based on expectation interest may include lost profit because the promisee is reimbursed for the actual value of the contract had it been performed. Farnsworth at 813. Reimbursement based on reliance interest includes expenses of preparation, performance, or lost

opportunities to make other contracts. *Id.* In contrast to protection of expectation and reliance interests,

the object of restitution is not the enforcement of a promise, but rather the prevention of unjust enrichment. The focus is on the party in breach, rather than on the injured party, and the attempt is to put the party in breach back in the position in which he would have been had the contract not been made. The party in breach is required to disgorge what he has received in money or services by, for example, returning the benefit to the injured party who conferred it on him. [The restitution interest] is ordinarily smaller than either the expectation or the reliance interest. Although recovery measured by either of these interests takes account of cost incurred in conferring a benefit on the party in breach, the restitution interest includes neither the injured party's lost profit nor the part of his expenditures in reliance that conferred no benefit on the party in breach.

Id. at 814.

[¶12] Remedies for breach of contract may be "specific," that is, providing the injured party with the promised performance, or "substitutional," giving the promisee something in substitution for the promised performance. See Farnsworth § 12.2, at 815. Whether a judicial remedy is "legal" or "equitable" turns on the nature of the relief sought.

The principal legal remedy to enforce a promise is a judgment awarding a sum of money. This is usually substitutional relief, as when the sum is damages to compensate the injured party for breach; but it may also be specific, as when the sum is the amount due under a contract. The principal equitable remedy to enforce a contract is an order requiring specific performance of the contract or enjoining its nonperformance. This is specific relief.

Id. Remedies for a seller's breach of a land installment contract may protect any of the three interests and be legal or equitable, as well as specific or substitutional. See generally R. Hillman, *Contract Remedies, Equity, and Restitution in Iowa*, §§ 7.1-4, at 150-72 (1979) (hereafter *Hillman*). In general, equitable relief will be granted only when legal remedies are inadequate. *Berry Seed Co. v. Hutchings*, 247 Iowa 417, 422, 74 N.W.2d 233, 236 (1956).

[¶13] Rescission is a restitutionary remedy which attempts to restore the parties to their positions at the time the contract was executed. Note, *Forfeiture and the Iowa Installment Land Contract*, 46 Iowa L.Rev. 786, 793 (1961). The remedy calls for a return of the land to the seller, with the buyer given judgment for payments made under the contract plus the value of improvements, less reasonable rental value for the period during which the buyer was in possession. *Id.*; accord *Lutz v. Cunningham*, 240 Iowa 1037, 1055-56, 38 N.W.2d 638, 647 (1949); *Breja v. Pyrne*, 94 Iowa 755, 758, 64 N.W. 669, 670-71 (1895). The remedy has long been available in Iowa to buyers under land contracts when the seller has no title to convey. * * * *

[¶14] Rescission is considered an extraordinary remedy, however, and is ordinarily not available to a litigant as a matter of right but only when, in the discretion of the court, it is

necessary to obtain equity. *Capps v. Clark*, 196 Iowa 758, 763, 195 N.W. 372, 375 (1923). Our cases have established three requirements that must be met before rescission will be granted. First, the injured party must not be in default. * * * *Binkholder v. Carpenter*, 260 Iowa 1297, 1308, 152 N.W.2d 593, 600 (1967). Second, the breach must be substantial and go to the heart of the contract. *Maytag*, 253 Iowa at 464, 112 N.W.2d at 660; *Nora Springs Cooperative Co. v. Brandau*, 247 N.W.2d 744, 749 (Iowa 1976). Third, remedies at law must be inadequate. *Berry Seed Co.*, 247 Iowa at 422, 74 N.W.2d at 236 (1956).

[¶15] The first two tests are easily met in the present case. Potters are entirely without fault in this transaction. They tendered their 1985 installment payment to Oster before the forfeiture, and no additional payments were due until 1986. On the question of materiality, Oster's loss of equitable title to the homestead by forfeiture caused not only substantial, but total breach of his obligation to insure peaceful possession and convey marketable title under the Oster-Potter contract.

[¶16] Only the third test—the inadequacy of damages at law—is contested by Oster on appeal. Preliminarily, he questions the necessity of any judicial intervention to undo the contract, claiming it was effectively rescinded by the Stark-Oster forfeiture. From this premise, Oster argues the inexpediency of equitable relief and the adequacy of damages at law. We find the argument unpersuasive. It is true that Stark's forfeiture of Oster's interest in the property rendered performance under the Oster-Potter contract impossible. But there is no evidence in the record that either party acted to unilaterally rescind the agreement between them. Whether a rescission is accomplished in pais, or through resort to a court of equity, the side obligations resulting from termination of the contract still remain for judicial determination in order to restore the status quo. See *Binkholder*, 260 Iowa at 1304, 152 N.W.2d at 596-97.

[¶17] Restoring the status quo is the goal of the restitutionary remedy of rescission. *Hillman* § 3.3(F), at 74; see also *Kilpatrick v. Smith*, 236 Iowa 584, 596, 19 N.W.2d 699, 705 (1945). Here, the district court accomplished the goal by awarding Potters a sum representing all they had paid under the contract rendered worthless by Oster's default. Oster contends that in an era of declining land values, such a remedy goes beyond achieving the status quo and results in a windfall to the Potters. Unwilling to disgorge the benefits he has received under the unfulfilled contract, Oster would have the court shift the "entrepreneurial risk" of market loss to the Potters by limiting their recovery to the difference between the property's market value at breach (\$35,000) and the contract balance (\$27,900). In other words, Oster claims the court should have awarded expectancy, rather than restitution, damages. For a number of reasons, the district court rejected this "benefit of the bargain" approach, and rightly so.

[¶18] First, Potters did not sue for expectancy damages. Theirs was not a claim based on the benefit they would have received had the contract been fulfilled; theirs was a claim for restitution of sums paid which unjustly enriched Oster at their expense. By selecting the remedy of rescission and restitution, rather than expectation or reliance damages, Potters

chose what is usually the smallest awardable recovery. See Farnsworth, at 814. Though declining land values may have motivated their selection of remedies in this case, their motive for exercising a legal right to rescind is immaterial if the remedy is otherwise appropriate. *Binkholder*, 260 Iowa at 1309, 152 N.W.2d at 600.

[¶19] Second, legal remedies are considered inadequate when the damages cannot be measured with sufficient certainty. *Berry Seed Co. v. Hutchings*, 247 Iowa 417, 422, 74 N.W.2d 233, 237 (1956). Contrary to Oster's assertion that Potters' compensation should be limited to the difference between the property's fair market value and contract balance at time of breach, expectation damages are correctly calculated as the difference between contract price and market value at the time for performance. See Hillman § 7.1(A), at 150 (citing *Yokum v. McBride*, 56 Iowa 139, 8 N.W. 705 (1881) and *Sweem v. Steele*, 5 Iowa 352 (1857)). Since the time of performance in this case would have been March 1990, the market value of the homestead and acreage cannot be predicted with any certainty, thus rendering such a formulation inadequate.

[¶20] Most importantly, the fair market value of the homestead at the time of forfeiture is an incorrect measure of the benefit Potters lost. It fails to account for the special value Potters placed on the property's location and residential features that uniquely suited their family. For precisely this reason, remedies at law are presumed inadequate for breach of a real estate contract. *Dee v. Collins*, 235 Iowa 22, 24, 15 N.W.2d 883, 885 (1944); Hillman § 7.1, at 151. Oster has failed to overcome that presumption here. His characterization of the transaction as a mere market loss for Potters, compensable by a sum which would enable them to make a nominal down payment on an equivalent homestead, has no legal or factual support in this record. As one commentator has observed, acreages are not fungible goods:

Unlike the purchaser of goods who, after receiving an anticipatory repudiation, can go out on the market and purchase a market substitute, and therefore suffers damages measured by the difference between the contract and market prices at the time buyer could reasonably cover, the purchaser of real property cannot cover because real property is considered to be unique there is no market substitute.

Hillman § 7.1, at 151.

[¶21] From Oster's perspective, Potters actually benefited from the forfeiture because their purchase, in light of subsequent events, proved to be unprofitable. But the record convinces us that profit measured by Wall Street standards was of little consequence to Potters. This was the Potters' home, the place their first son was born, the place Charles Potter testified "was worth everything we ever gave for it, because we planned on living there the rest of our lives."

[¶22] In summary, we find no error in the trial court's conclusion that Potters were entitled to rescission of the contract and return of all benefits allowed thereunder, less the value of reasonable rental for the period of occupancy.

[¶23] II. Oster also challenges the trial court's refusal to reduce the award based on Potters' alleged failure to mitigate their loss. The record reveals that when Charles Potter learned of the impending forfeiture, he offered Stark the balance of \$27,900 due on Potters' contract with Oster (\$20,000 more than the installment due March 1) in order to protect their interest in the property. Stark rejected the offer but indicated a willingness to sell Potters the property for \$50,000. Because Potters had already paid nearly \$60,000 toward the property, they considered the counter offer unreasonable. They made no mention of this communication to Oster.

[¶24] Oster claimed at trial that had he known Stark was willing to negotiate on any terms for the Potter homestead, he could have attempted to bargain with her to avoid the forfeiture. But the record amply supports the trial court's conclusion that, beyond this bald assertion, Oster offered insufficient proof to prevail on this defense. The record is devoid of any convincing evidence that Oster would have been willing or able to make the financial commitment necessary to save the Potters' acreage, in light of his perception of its diminished value. The assignment is without merit.

AFFIRMED.

Questions:

1. What would an expectation measure of damages have given Potter?
2. What would a reliance measure of damages have given Potter? Why didn't the court order reliance damages?
3. How much does it matter in this opinion that Potter chose to ask for restitution?
4. What is the argument in paragraph 24? Should Oster's opportunity, willingness, or even an attempt to bargain with Stark affect the remedy that the Potters obtain from Oster?

Note: The court does not clearly explain this, but restitution can be ordered in several contexts. First, when a court orders rescission, often the court will order restitution to help place the parties back where they were at the time the contract was executed. Second, restitution can be ordered on its own as a remedy for breach of contract. Sometimes, it is the breach remedy plaintiffs choose. Third, restitution is the remedy for the cause of action for unjust enrichment. Finally, restitution is often the remedy for breach of fiduciary duty (a special duty that arises sometimes in relationships, some of which are created by contract), where it is sometimes called "constructive trust." In *Potter*, the court sometimes discusses the first of these, and sometimes the second, and obliquely refers to the third. This can be confusing, but case law in which courts discuss the common law broadly but also with complete clarity are extremely rare.

SULLIVAN v. O'CONNOR
Mass. (1973), 296 N.E.2d 183

KAPLAN, J.

[¶1] The plaintiff patient secured a jury verdict of \$13,500 against the defendant surgeon for breach of contract in respect to an operation upon the plaintiff's nose.

[¶2] [The plaintiff's complaint contained two counts. In the first, she alleged that the defendant, a surgeon "promised to perform plastic surgery on her nose and thereby to enhance her beauty and improve her appearance; that he performed the surgery but failed to achieve the promised result; rather the result of the surgery was to disfigure and deform her nose, to cause her pain in body and mind, and to subject her to other damage and expense." The second count was for malpractice.

[¶3] The case was tried by a jury, which returned a verdict for the plaintiff on the first count, and against her on the second.] The judge then instructed the jury on the issue of damages.

[¶4] * * * * The plaintiff was a professional entertainer, and this was known to the defendant. * * * * More particularly, judging from exhibits, the plaintiff's nose had been straight, but long and prominent; the defendant undertook by two operations to reduce its prominence and somewhat to shorten it, thus making it more pleasing in relation to the plaintiff's other features. Actually the plaintiff was obliged to undergo three operations, and her appearance was worsened. Her nose now had a concave line to about the midpoint, at which it became bulbous; viewed frontally, the nose from bridge to midpoint was flattened and broadened, and the two sides of the tip had lost symmetry. This configuration evidently could not be improved by further surgery. The plaintiff did not demonstrate, however, that her change of appearance had resulted in loss of employment. Payments by the plaintiff covering the defendant's fee and hospital expenses were stipulated at \$622.65.

[¶5] The judge instructed the jury, first, that the plaintiff was entitled to recover her out-of-pocket expenses incident to the operations. Second, she could recover the damages flowing directly, naturally, proximately, and foreseeably from the defendant's breach of promise. These would comprehend damages for any disfigurement of the plaintiff's nose - - that is, any change of appearance for the worse -- including the effects of the consciousness of such disfigurement on the plaintiff's mind, and in this connection the jury should consider the nature of the plaintiff's profession. Also consequent upon the defendant's breach, and compensable, were the pain and suffering involved in the third operation, but not in the first two. As there was no proof that any loss of earnings by the plaintiff resulted from the breach, that element should not enter into the calculation of damages. * * * *

[¶6] The plaintiff on her part excepted to the judge's refusal of a request to charge that the plaintiff could recover the difference in value between the nose as promised and the nose as it appeared after the operations. However, the plaintiff in her brief expressly waives this exception and others made by her in case this court overrules the defendant's exceptions; thus she would be content to hold the jury's verdict in her favor.

[¶7] We conclude that the defendant's exceptions should be overruled.

[¶8] [The court first expresses some discomfort with the whole idea of holding physicians to breach of contract in cases such as this, but the law allows them, the court concluded.]

[¶9] If an action on the basis of contract is allowed, we have next the question of the measure of damages to be applied where liability is found. Some cases have taken the simple view that the promise by the physician is to be treated like an ordinary commercial promise, and accordingly that the successful plaintiff is entitled to a standard measure of recovery for breach of contract—"compensatory" ("expectancy") damages, an amount intended to put the plaintiff in the position he would be in if the contract had been performed, or, presumably, at the plaintiff's election, "restitution" damages, an amount corresponding to any benefit conferred by the plaintiff upon the defendant in the performance of the contract disrupted by the defendant's breach. See Restatement: Contracts Section 329 and comment a, Sections 347, 384 (1). Thus in *Hawkins v. McGee*, 84 N. H. 114, the defendant doctor was taken to have promised the plaintiff to convert his damaged hand by means of an operation into a good or perfect hand, but the doctor so operated as to damage the hand still further. The court, following the usual expectancy formula, would have asked the jury to estimate and award to the plaintiff the difference between the value of a good or perfect hand, as promised, and the value of the hand after the operation. (The same formula would apply, although the dollar result would be less, if the operation had neither worsened nor improved the condition of the hand.) If the plaintiff had not yet paid the doctor his fee, that amount would be deducted from the recovery. There could be no recovery for the pain and suffering of the operation, since that detriment would have been incurred even if the operation had been successful; one can say that this detriment was not "caused" by the breach. But where the plaintiff by reason of the operation was put to more pain than he would have had to endure, had the doctor performed as promised, he should be compensated for that difference as a proper part of his expectancy recovery. It may be noted that on an alternative count for malpractice the plaintiff in the *Hawkins* case had been nonsuited; but on ordinary principles this could not affect the contract claim, for it is hardly a defence to a breach of contract that the promisor acted innocently and without negligence. * * * *

[¶10] Other cases, including a number in New York, without distinctly repudiating the *Hawkins* type of analysis, have indicated that * * * the plaintiff is to recover any expenditures made by him and for other detriment (usually not specifically described in the opinions) following proximately and foreseeably upon the defendant's failure to carry out

his promise. * * * * This, be it noted, is not a "restitution" measure, for it is not limited to restoration of the benefit conferred on the defendant (the fee paid) but includes other expenditures, for example, amounts paid for medicine and nurses; so also it would seem according to its logic to take in damages for any worsening of the plaintiff's condition due to the breach. Nor is it an "expectancy" measure, for it does not appear to contemplate recovery of the whole difference in value between the condition as promised and the condition actually resulting from the treatment. Rather the tendency of the formulation is to put the plaintiff back in the position he occupied just before the parties entered upon the agreement, to compensate him for the detriments he suffered in reliance upon the agreement. This kind of intermediate pattern of recovery for breach of contract is discussed in the suggestive article by Fuller and Perdue, *The Reliance Interest in Contract Damages*, 46 Yale L. J. 52, 373, where the authors show that, although not attaining the currency of the standard measures, a "reliance" measure has for special reasons been applied by the courts in a variety of settings, including noncommercial settings. See 46 Yale L. J. at 396-401.

[¶11] For breach of the patient-physician agreements under consideration, a recovery limited to restitution seems plainly too meager, if the agreements are to be enforced at all. On the other hand, an expectancy recovery may well be excessive. The factors, already mentioned, which have made the cause of action somewhat suspect, also suggest moderation as to the breadth of the recovery that should be permitted. Where, as in the case at bar and in a number of the reported cases, the doctor has been absolved of negligence by the trier, an expectancy measure may be thought harsh. We should recall here that the fee paid by the patient to the doctor for the alleged promise would usually be quite disproportionate to the putative expectancy recovery. To attempt, moreover, to put a value on the condition that would or might have resulted, had the treatment succeeded as promised, may sometimes put an exceptional strain on the imagination of the fact finder. As a general consideration, Fuller and Perdue argue that the reasons for granting damages for broken promises to the extent of the expectancy are at their strongest when the promises are made in a business context, when they have to do with the production or distribution of goods or the allocation of functions in the market place; they become weaker as the context shifts from a commercial to a noncommercial field. 46 Yale L. J. at 60-63.

[¶12] There is much to be said, then, for applying a reliance measure to the present facts, and we have only to add that our cases are not unreceptive to the use of that formula in special situations. We have, however, had no previous occasion to apply it to patient-physician cases. The question of recovery on a reliance basis for pain and suffering or mental distress requires further attention. We find expressions in the decisions that pain and suffering (or the like) are simply not compensable in actions for breach of contract. The defendant seemingly espouses this proposition in the present case. True, if the buyer under a contract for the purchase of a lot of merchandise, in suing for the seller's breach, should claim damages for mental anguish caused by his disappointment in the transaction, he would not succeed; he would be told, perhaps, that the asserted psychological injury was not fairly foreseeable by the defendant as a probable consequence of the breach of

such a business contract. See Restatement: Contracts, Section 341 and comment a. But there is no general rule barring such items of damage in actions for breach of contract. It is all a question of the subject matter and background of the contract, and when the contract calls for an operation on the person of the plaintiff, psychological as well as physical injury may be expected to figure somewhere in the recovery, depending on the particular circumstances. The point is explained in *Stewart v. Rudner*, 349 Mich. 459, 469. Cf. *Frewen v. Page*, 238 Mass. 499 ; *McClean v. University Club*, 327 Mass. 68 . Again, it is said in a few of the New York cases, concerned with the classification of actions for statute of limitations purposes, that the absence of allegations demanding recovery for pain and suffering is characteristic of a contract claim by a patient against a physician, that such allegations rather belong in a claim for malpractice. See *Robins v. Finestone*, 308 N. Y. 543, 547; *Budoff v. Kessler*, 2 App. Div. 2d (N. Y.) 760. These remarks seem unduly sweeping. Suffering or distress resulting from the breach going beyond that which was envisaged by the treatment as agreed, should be compensable on the same ground as the worsening of the patient's conditions because of the breach. Indeed it can be argued that the very suffering or distress "contracted for"—that which would have been incurred if the treatment achieved the promised result—should also be compensable on the theory underlying the New York cases. For that suffering is "wasted" if the treatment fails. Otherwise stated, compensation for this waste is arguably required in order to complete the restoration of the status quo ante.*

[¶13] In the light of the foregoing discussion, all the defendant's exceptions fail: the plaintiff was not confined to the recovery of her out-of-pocket expenditures; she was entitled to recover also for the worsening of her condition,[†] and for the pain and suffering and mental distress involved in the third operation. These items were compensable on either an expectancy or a reliance view. We might have been required to elect between the two views if the pain and suffering connected with the first two operations contemplated by the agreement, or the whole difference in value between the present and the promised conditions, were being claimed as elements of damage. But the plaintiff waives her possible

* Recovery on a reliance basis for breach of the physician's promise tends to equate with the usual recovery for malpractice, since the latter also looks in general to restoration of the condition before the injury. But this is not paradoxical, especially when it is noted that the origins of contract lie in tort. See Farnsworth, *The Past of Promise: An Historical Introduction to Contract*, 69 Col. L. Rev. 576, 594-596; Breitel, J. in *Stella Flour & Feed Corp. v. National City Bank*, 285 App. Div. (N. Y.) 182, 189 (dissenting opinion). A few cases have considered possible recovery for breach by a physician of a promise to sterilize a patient, resulting in birth of a child to the patient and spouse. If such an action is held maintainable, the reliance and expectancy measures would, we think, tend to equate, because the promised condition was preservation of the family status quo. *

It would, however, be a mistake to think in terms of strict "formulas." For example, a jurisdiction which would apply a reliance measure to the present facts might impose a more severe damage sanction for the wilful use by the physician of a method of operation that he undertook not to employ.

[†] That condition involves a mental element and appraisal of it properly called for consideration of the fact that the plaintiff was an entertainer. Cf. *McQuaid v. Michou*, 85 N. H. 299, 303-304 (discussion of continuing condition resulting from physician's breach).

claim to the former element, and to so much of the latter as represents the difference in value between the promised condition and the condition before the operations.

Plaintiff's exceptions waived.

Defendant's exceptions overruled.

Questions:

1. Was the court's second instruction on damages incorrect? On this question, of what relevance is the footnote to paragraph 12?
2. Is the court dead set against giving expectancy?
3. Are mental anguish damages a legitimate measure of harm from breach of contract? Consider the following case:

DEITSCH v. THE MUSIC COMPANY
Ohio App. (1983), 453 N.E.2d 1302

PAINTER, J.

[¶1] This is an action for breach of contract. Plaintiffs and defendant entered into a contract on March 27, 1980, whereby defendant was to provide a four-piece band at plaintiffs' wedding reception on November 8, 1980. The reception was to be from 8:00 p.m. to midnight. The contract stated "wage agreed upon - \$295.00," with a deposit of \$65, which plaintiffs paid upon the signing of the contract.

[¶2] Plaintiffs proceeded with their wedding, and arrived at the reception hall on the night of November 8, 1980, having employed a caterer, a photographer and a soloist to sing with the band. However, the four-piece band failed to arrive at the wedding reception. Plaintiffs made several attempts to contact defendant but were not successful. After much wailing and gnashing of teeth, plaintiffs were able to send a friend to obtain some stereo equipment to provide music, which equipment was set up at about 9:00 p.m.

[¶3] This matter came on to be tried on September 28, 1982. Testimony at trial indicated there were several contacts between the parties from time to time between March and November 1980. The testimony of plaintiff Carla Deitsch indicated that she had taken music to the defendant several weeks prior to the reception and had received a telephone call from defendant on the night before the wedding confirming the engagement. Defendant's president testified that he believed the contract had been cancelled, since the word "cancelled" was written on his copy of the contract. There was no testimony as to when that might have been done, and no one from defendant-company was able to explain the error. There was also testimony that defendant's president apologized profusely to the

mother of one of the plaintiffs, stating that his "marital problems" were having an effect on his business, and it was all a grievous error.

[¶4] The court finds that defendant did in fact breach the contract and therefore that plaintiffs are entitled to damages. The difficult issue in this case is determining the correct measure and amount of damages.

[¶5] Counsel for both parties have submitted memoranda on the issue of damages. However, no cases on point are cited. Plaintiffs contend that the entire cost of the reception, in the amount of \$2,643.59, is the correct measure of damages. This would require a factual finding that the reception was a total loss, and conferred no benefit at all on the plaintiffs. Defendant, on the other hand, contends that the only measure of damages which is proper is the amount which plaintiffs actually lost, that is, the \$65 deposit. It is the court's opinion that neither measure of damages is proper; awarding to plaintiffs the entire sum of the reception would grossly overcompensate them for their actual loss, while the simple return of the deposit would not adequately compensate plaintiffs for defendant's breach of contract.

[¶6] Therefore, we have to look to other situations to determine whether there is a middle ground, or another measure of damages which would allow the court to award more than the deposit, but certainly less than the total cost of the reception.

[¶7] It is hornbook law that in any contract action, the damages awarded must be the natural and probable consequence of the breach of contract or those damages which were within the contemplation of the parties at the time of making the contract. *Hadley v. Baxendale* (1854), 9 Exch. 341, 156 Eng. Rep. 145.

[¶8] Certainly, it must be in the contemplation of the parties that the damages caused by a breach by defendant would be greater than the return of the deposit — that would be no damages at all.

[¶9] The case that we believe is on point is *Pullman Company v. Willett* (Richland App. 1905), 7 Ohio C.C. (N.S.) 173, affirmed (1905), 72 Ohio St. 690. In that case, a husband and wife contracted with the Pullman Company for sleeping accommodations on the train. When they arrived, fresh from their wedding, there were no accommodations, as a result of which they were compelled to sit up most of the night and change cars several times. The court held that since the general measure of damages is the loss sustained, damages for the deprivation of the comforts, conveniences, and privacy for which one contracts in reserving a sleeping car space are not to be measured by the amount paid therefor. The court allowed compensatory damages for the physical inconvenience, discomfort and mental anguish resulting from the breach of contract, and upheld a jury award of \$125. The court went on to state as follows:

"It is further contended that the damages awarded were excessive. We think not. The peculiar circumstances of this case were properly [a] matter for the

consideration of the jury. The damages for deprivation of the comforts, conveniences and privacy for which he had contracted and agreed to pay are not to be measured by the amount to be paid therefor. He could have had cheaper accommodations had he so desired, but that he wanted these accommodations under the circumstances of this case was but natural and commendable, and we do not think that the record fails to show any damages, but, on the contrary it fully sustains the verdict and would, in our opinion, sustain even a larger verdict had the jury thought proper to fix a larger amount." (Emphasis added.) *Pullman Company v. Willett*, supra, at 177-78; see, also, 49 Ohio Jurisprudence 2d 191, *Sleeping Car Companies*, Section 6.

[¶10] Another similar situation would be the reservation of a room in a hotel or motel. Surely, the damages for the breach of that contract could exceed the mere value of the room. In such a case, the Hawaii Supreme Court has held the plaintiff was "not limited to the narrow traditional contractual remedy of out-of-pocket losses alone." *Dold v. Outrigger Hotel* (1972), 54 Haw. 18, 22, 501 P.2d 368, at 371-372.

[¶11] The court holds that in a case of this type, the out-of-pocket loss, which would be the security deposit, or even perhaps the value of the band's services, where another band could not readily be obtained at the last minute, would not be sufficient to compensate plaintiffs. Plaintiffs are entitled to compensation for their distress, inconvenience, and the diminution in value of their reception. For said damages, the court finds that the compensation should be \$750. Since plaintiffs are clearly entitled to the refund of their security deposit, judgment will be rendered for plaintiffs in the amount of \$815 and the costs of this action.

Judgment accordingly.

Questions:

1. What does Judge Painter mean by a "case of this type"? What other cases might be "of this type"?
2. Is emotional distress expectation, reliance, or restitution?
3. Why was \$295 not enough? Is music always worth more than one pays for it? How does the court come up with \$750 without speculating? (Findings are supposed to be based on evidence.)

2. Expectation

AMERICAN STANDARD, INC. v. SCHECTMAN
Supreme Court of New York, App. Div. (1981), 80 A.D.2d 318, 439 N.Y.S.2d 529

HANCOCK, JR., J.

[¶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. 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. 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 trammelled 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 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.

Questions:

1. Do you think that American Standard or the new owner used the money to tear out the foundations and regrade the property?
2. Suppose that the breach of the contract was for leaving a building standing rather than just failing to tear out foundations, and that prior to the sale of the property the vacant building was used by a young movie producer to shoot a movie. Suppose further that the movie comes out and is a tremendous hit before it is time for Schectman to tear down the building, and Schectman decides not to tear down the building because the purchaser of the property wants to build a dance and comedy club in it. Because of these novel events, the price of the sale is \$286,000, over \$100,000 more than the appraised price of the lot. With these added facts, should American Standard be awarded diminution in value or cost of completion?
3. Suppose Jean, whose residential lot in the back borders the local state courthouse lot, wants artist Mark to build a statue in her backyard called "salute to waste." In Mark's model, the statue is twelve feet tall and five feet wide. It is to be covered with non-biodegradable waste materials—various plastic items, including milk cartons, fast food restaurant straws and drink covers, garbage bags; various metal items, including broken appliances and parts of appliances; various rubber items, including bald tires, of course; and broken glass. In addition to the monument itself, various similar items of garbage are to be attached to the ground around the monument. Jean is to pay Mark \$20,000 for the statue. Mark is only one of two garbage artists working in the state. Now suppose Mark repents and refuses to complete it after he is half done. The other, more well-known artist, Oscar, will complete the job for no less than \$25,000. In fact, the salute to waste had decreased the value of the property considerably, as well as that of neighboring properties. Jean has sued Mark for breach. What should a court do?
4. Why can't the court in *American Standard* fix an intermediate amount that is fair?

RIVERS v. DEANE

Supreme Court of New York, App. Div. (1994), 619 N.Y.S.2d 419

[¶1] Judgment unanimously modified on the law and as modified affirmed without costs and matter remitted to Supreme Court for further proceedings in accordance with the following Memorandum: Defendant appeals from a judgment of Supreme Court awarding plaintiffs damages for defendant's breach of contract for the construction of an addition to plaintiffs' home. Defendant in his brief challenges only that aspect of the judgment that awarded damages to plaintiffs for the difference between the market value of the structure had it been completed pursuant to the terms of the contract and the market value of the structure as actually completed. We agree with defendant's assertion that the record does not support the court's award for diminution in value, because no such proof was presented.

[¶2] At trial plaintiffs produced two experts who testified that defendant failed to construct the addition in a good and workmanlike manner. They further testified that the inadequate structural support of the addition rendered unusable the third floor of the addition, which plaintiffs had intended to use as a master bedroom and bathroom. The appeal by defendant, as limited by his brief (see, *Ciesinski v Town of Aurora*, 202 A.D.2d 984; *Hodge v LoRusso*, 181 A.D.2d 1009), does not contest those findings of fact.

[¶3] The general rule in cases of faulty construction is that the measure of damages is the market value of the cost to repair the faulty construction (see, *American Std. v Schectman*, 80 A.D.2d 318, lv denied 54 N.Y.2d 604). The court erred in applying the "difference in value rule", as initially set forth by Justice Cardozo in *Jacob & Youngs v Kent* (230 N.Y. 239, 241), which is limited to instances where the builder's failure to perform under a construction contract is "both trivial and innocent", such that damages may be measured by the diminution in value of the building rather than the cost of tearing apart the structure and properly completing the project. Where, as here, the defect arising from the breach of the contract "is so substantial as to render the finished building partially unusable and unsafe, the measure of damage is 'the market price of completing or correcting the performance'" (*Bellizzi v Huntley Estates*, 3 N.Y.2d 112, 115, quoting 5 Williston, Contracts § 1363, at 3825 [rev ed]). Thus, on the facts found by the court, plaintiffs are entitled to the market value of the cost of correcting the deficiencies in the addition arising from defendant's breach.

[¶4] The trier of fact is in the best position to evaluate the credibility of the witnesses, who gave conflicting testimony concerning the cost of repair to the addition. Therefore, we modify the judgment appealed from by vacating the court's award of \$10,000 for diminution in value due to inadequate structural support, and we remit the matter to Supreme Court for further findings of fact on the actual cost of repair for inadequate structural support and direct that judgment be entered accordingly.

[¶5] Judgment unanimously modified on the law and as modified affirmed without costs and matter remitted to Supreme Court for further proceedings.

Questions:

1. What is the general rule?
2. Did the builder substantially perform?
3. In *Jacob & Youngs v. Kent* the contractor wanted diminution of value to be the measure of damages, not cost of completion of the structure according to the contract. In this case, the contractor wants the opposite. Why was the construction company here wanting to change the measure to cost of repair from diminution in value, do you think?

4. Suppose the owner collects repair costs because they are greater than diminution, and then sells the property. If the owner collects repair costs because they are greater than diminution in value, and then sells the property, doesn't the owner get a windfall?

5. Read again *New Era Homes v. Foster*. Is the damage formula in that case consistent with the formula in this case?

3. Reliance

BECO CONSTRUCTION COMPANY, INC. v. HARPER CONTRACTING, INC.
Idaho App. (1997), 936 P.2d 202

[¶1] In this appeal we are asked to review the district court's order denying motions for directed verdict, judgment notwithstanding the verdict and new trial. * * * * We affirm.

I. FACTS AND PROCEDURE

[¶2] Harper Contracting, Inc., was a subcontractor involved in the construction of a prison in Ely, Nevada. The general contractor, Layton Construction, contacted Beco Construction Co., Inc., regarding the placement of asphalt at the prison construction site. Harper, relying on a proposal submitted by Beco to Layton, hired Beco to produce and lay asphalt for the site. Beco prepared gravel and provided gravel testing, but did not place the asphalt. The parties terminated their relationship, and Beco filed a complaint seeking compensation from Harper for the gravel and gravel testing. Beco's complaint alleged that Harper owed money to Beco "on open account."

[¶3] During a hearing on a motion in limine, Harper moved to exclude evidence regarding the circumstances surrounding the termination of the asphalt contract. The district court granted the motion in part, but indicated it would allow information regarding the termination of the contract to be introduced as evidence relating to impeachment, credibility or perspective. The case then proceeded to trial before a jury. After Beco rested its case, Harper moved for a directed verdict. The district court denied the motion, stating that the question at issue was whether there was a contract, and that substantial evidence existed which justified submission of the issue to the jury.

[¶4] At the conclusion of the trial, the jury returned a verdict which was internally inconsistent. The jury found that Beco had waived its right to reimbursement for the testing services and then went on to award damages to Beco for those services. After discussion with counsel, and over the objection of Harper, the district court refused the verdict and asked the jury to continue its deliberations. The jury later returned a consistent verdict awarding Beco \$1,484.20 for the testing services and \$6,412.50 for the gravel. Harper then

filed a motion for judgment notwithstanding the verdict (j.n.o.v.) or, in the alternative, for a new trial. The district court denied the motion. * * * *

[¶5] Harper appeals, claiming that the district court erred in denying the motions for directed verdict, j.n.o.v. and new trial. * * * *

II. ANALYSIS

A. Direct Appeal Issues * * * *

(2) J.N.O.V.

[¶6] After the completion of the trial, Harper moved for a j.n.o.v., I.R.C.P. 50(b), or, in the alternative, for a new trial, I.R.C.P. 59(a). In considering the district court's denial of Harper's j.n.o.v. motion, this Court is to review the record of the trial court and determine whether, as a matter of law, there was sufficient evidence upon which reasonable jurors could return a verdict in favor of the plaintiffs; or, as stated by our Supreme Court, whether “there can be but one conclusion as to the verdict that reasonable minds could have reached.” * * * *

[¶7] If an alternative motion for new trial is made with the j.n.o.v. motion, the trial court must rule on both motions separately. * * * * The district court in this case analyzed the issues separately and independently for each motion. The district court also recognized the relevant standards and legal principles applicable to a motion for j.n.o.v.

[¶8] On appeal, Harper argues that no contract issues could be raised at trial for two reasons: (1) Beco's complaint sought compensation on a non-contract theory, open account, and Harper never consented to try another issue; and (2) the district court's order on Harper's motion in limine limited the scope of the trial. Harper also claims that regardless of the nature of the claim, Beco failed to provide sufficient evidence to support the jury's verdict or award.

[¶9] We note, first, that Harper seems to misapprehend the nature of an open account. Harper argues that Beco provided inadequate notice that a contract claim would be pursued at trial; however, the very basis of the action was a contract claim. An open account refers to a continuing series of transactions between the parties, where the balance is unascertained and future transactions between the parties are expected. *Seubert Excavators, Inc. v. Eucon Corp.*, 125 Idaho 409, 415, 871 P.2d 826, 832 (1994). Although an open account is a particularized type of contract claim, it is a contract claim. Harper had notice that a contract claim would be presented to the jury. Therefore, Harper's “consent” to try a contract claim was not required. * * * *

[¶10] Beco sought recovery of the out-of-pocket expenses incurred in anticipation of performance of the contract with Harper. A party aggrieved by a breach of contract may be entitled to reimbursement for losses caused by its reliance on the contract, even if the aggrieved party elects to rescind the contract. *Brown v. Yacht Club of Coeur d'Alene, Ltd.*, 111 Idaho 195, 198, 722 P.2d 1062, 1065 (Ct.App.1986). Reliance damages include expenses reasonably related to the purposes of the contract which would not have been incurred but for the contract's existence. *Id.* at 198-200, 722 P.2d at 1065-1067. Beco's evidence showed that it incurred expenses in crushing and testing gravel in preparation for performance of the asphalt contract. After a thorough review of the record, we conclude that there was substantial competent evidence to support the jury's verdict that Harper was obligated to pay Beco for the crushing and testing of gravel.

[¶11] Harper claims that the amount of the jury award was unsupported in the record. Beco's prayer for relief sought compensation for 1,200 tons of gravel. However, Beco's president, Doyle Beck, testified that Beco estimated 1,500 tons of asphalt would be needed for the prison construction job. He further testified that approximately ninety-five percent of the weight of asphalt can be attributed to the gravel. According to Beck's testimony, 1,425 tons of gravel would be needed for the production of asphalt for the prison site. Beck indicated that Beco had actually prepared 1,700 to 1,800 tons of gravel. When asked why Beco only billed Harper for 1,200 tons, Beck explained:

That was still, in my mind, at that point I didn't know for sure how many tons it was going to take. Okay. I didn't want to bill for something that could be disputed.

In situations like this if we get enough to cover the diesel fuel and labor and some raw expenses, that's really all we want at that point.

[¶12] Evidence presented at trial also indicated that the cost to Beco for crushing gravel was approximately \$4.50 per ton or higher and that this was a competitive price. The jury awarded \$6,412.50, the product of 1,425 tons multiplied by \$4.50 per ton. Thus, there was substantial competent evidence in the record to support the amount of the jury's verdict.

* * * *

III. CONCLUSION

[¶13] The district court correctly perceived that the parties tried a simple contract claim and that Harper had adequate notice of that fact. Further, the district court properly determined that there was sufficient, competent evidence to support the jury's verdict, including the amount of the award. * * * *

Questions:

1. What is the difference between expectation and reliance damages? Can you state the difference succinctly?
2. Given that expectation gives what it does, one might suspect most parties would prefer it; it reflects the value of the parties' bargain. Why do the courts grant *Beco* reliance damages instead of expectation, according to this opinion?
3. Are reliance damages available even for costs incurred in preparing to perform?
4. For what amount of gravel did *Beco* bill Harper? For what amount did it actually incur costs? For what amount did the jury actually award damages?

Joseph TOSCANO v. GREENE MUSIC
Cal. App. (2004), 21 Cal.Rptr.3d 732

O'ROURKE, J.

[¶1] Joseph Toscano sued Greene Music (Greene) for promissory estoppel stemming from Greene's unfulfilled promise of employment, which caused Toscano to resign from an at-will employment position with his former employer. The court awarded Toscano damages including lost wages based on what Toscano would have earned from his former employer to the time of his retirement. Greene appeals from the judgment, contending such future wages are impermissible reliance damages and are speculative as a matter of law. We hold such damages are recoverable on a promissory estoppel theory as long as they are not speculative or remote and are supported by substantial evidence, but they are not available to Toscano under the evidence in this case. Accordingly, we vacate the award of damages to Toscano for lost future earnings from September 1, 2001, to his retirement and remand the matter to the trial court for retrial limited to the amount of those damages only. We affirm the judgment in all other respects.

FACTUAL AND PROCEDURAL BACKGROUND

[¶2] We state the unchallenged facts as found by the trial court in its statement of decision.

[¶3] In 2001, Joseph Toscano, who was employed as the general manager of a Fields Pianos (Fields) store in Santa Ana, was very unhappy with his job and decided to find other employment. Toscano contacted Michael Greene, the president of San Diego-based Greene, because he had heard that Greene was considering buying Fields's Riverside store. During the course of several conversations in June and July of 2001, Michael Greene offered Toscano a sales management position with Greene to start on September 1, 2001.

On August 1, 2001, Toscano resigned from Fields in reliance on Michael Greene's promise of employment. In mid-August, however, Greene withdrew the employment offer. Toscano later found lesser paying jobs; the first at a piano store in Mission Viejo and then at another piano store in Utah.

[¶4] Toscano sued Greene for breach of contract, breach of the implied covenant of good faith and fair dealing, promissory estoppel and interference with prospective economic advantage. Only his claim for promissory estoppel survived summary adjudication, and the matter proceeded to a bench trial.

[¶5] Before trial, Greene moved in limine to prevent introduction of evidence or testimony on any claimed expectancy damages. It maintained such damages were not recoverable under a theory of promissory estoppel; that because the court had already ruled that Toscano was promised only at-will employment with Greene in connection with its motion for summary adjudication, Toscano was limited to reliance damages consisting of one month's lost salary from Fields for the month of August 2001. Toscano opposed the motion, arguing his reliance damages included "lost earnings and benefits after September 1, 2001[,] based upon what he would have continued to earn had he remained working at Fields, and not relied upon Greene Music's promise of employment." The parties filed supplemental trial briefs on the damages issue.

[¶6] The trial court denied Greene's motion. It ultimately ruled in Toscano's favor, awarding him \$536,833 in damages. In its statement of decision, the court ruled Toscano was limited to reliance damages, but that those damages included "lost wages that the employee would have earned from the job that he quit in reliance on the employer's promise, or from a job he declined in reliance upon the promise." Based on the testimony of Toscano's accountant expert, Roberta Spoon, the court concluded Toscano's total past and future economic loss was \$536,833. Spoon had testified Toscano's past lost wages were \$119,061: the difference between Toscano's actual earnings and what he would have earned at Fields from August 1, 2001, to June 1, 2003. She calculated Toscano's future lost earnings and benefits—the present value of the difference between what he would have earned at Fields and what he would earn in his new job until his retirement in 2017—to be \$417,772.

[¶7] In its statement of decision, the court found "[w]hile the evidence indicates that Toscano had changed jobs several times in the past, and that he was looking for an opportunity to leave Fields Pianos, there is no evidence that indicates he would have left Fields for a job which pays substantially less than he was earning there. Thus, even if one assumes that Toscano would have left Fields Pianos at some time in the future, one must also assume that he would do so only for a job which paid him as much, or more, than he would earn at Fields Pianos: after all, that is exactly what happened in this case. In light of this evidence, the Court finds that the sum of \$536,833 reasonably reflects the total economic harm that Toscano has suffered and will continue to suffer as a result of his reliance on Greene Music's promise of employment."

[¶8] Greene moved for a new trial. It argued the damage award was excessive because it included nonrecoverable expectancy damages and was speculative. Toscano maintained the award of lost wages from Fields were lost opportunity costs, a form of reliance damages. The court denied Greene's motion. This appeal followed.

DISCUSSION

I. Standard of Review

[¶9] The parties agree that the determination of whether Toscano is entitled to a particular measure of damages is a question of law subject to de novo review. * * * * The amount of damages, on the other hand, is a fact question committed to the discretion of the trial judge on a motion for new trial; an award of damages will not be disturbed if it is supported by substantial evidence. * * * * The evidence is insufficient to support a damage award only when no reasonable interpretation of the record supports the figure. * * * *

II. Promissory Estoppel Damages May Include an Employee's Definite, Nonspeculative Loss of Future Wages From Prior at-will Employment

[¶10] No California case has squarely addressed the damages question presented: whether a plaintiff who resigns from at-will employment in reliance on an unfulfilled promise of other employment may recover, under a promissory estoppel theory, reliance damages based on wages lost from his or her prior employment. Relying on several out of state authorities, Greene contends reliance damages do not include lost future earnings, because future earnings represent “expectancy” damages that are not recoverable under promissory estoppel, and an employee cannot prove entitlement to such earnings because there is no guarantee of future employment in an at-will setting. Greene maintains the only lost income recoverable in this case is Toscano's wages lost between the time he left his former job and the time the new promised job would have begun.

[¶11] Toscano concedes the weight of authority prevents an employee in his circumstances from recovering future lost wages from the prospective employer that induced him to resign his employment; he asserts, however, the law permits the employee to recover what he would have earned in the future from his former employer as a component of reliance damages. Greene [sic—Toscano?] maintains this measure of recovery is consistent with the equitable nature of promissory estoppel and with the trend in promissory estoppel cases permitting lost opportunity costs incurred in reliance on the defendant's promise.

[¶12] As we explain, we hold a plaintiff's lost future wages from the former at-will employer are recoverable under a promissory estoppel theory as long as they are not speculative or remote, and are supported by substantial evidence.

[¶13] “In California, under the doctrine of promissory estoppel, ‘A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.’ [Citations.] Promissory estoppel is ‘a doctrine which employs equitable principles to satisfy the requirement that consideration must be given in exchange for the promise sought to be enforced.’” *Kajima/Ray Wilson v. Los Angeles County Metropolitan Transportation Authority*, supra, 23 Cal.4th at p. 310, 96 Cal.Rptr.2d 747, 1 P.3d 63 see Rest.2d Contracts, § 90 subd. (1) p. 242; *C & K Engineering Contractors v. Amber Steel Co.* (1978) 23 Cal.3d 1, 6, 151 Cal.Rptr. 323, 587 P.2d 1136 (C & K.) The elements of promissory estoppel are (1) a clear promise, (2) reliance, (3) substantial detriment, and (4) damages “measured by the extent of the obligation assumed and not performed.” (See 1 Witkin, Summary of Cal. Law (9th ed. 1987) Contracts, §§ 249-250, p. 251.)

[¶14] The California Supreme Court has observed that “[u]nless there is unjust enrichment of the promisor, [promissory estoppel] damages should not put the promisee in a better position than performance of the promise would have put him.” (*Kajima/Ray*, supra, 23 Cal.4th at p. 316, 96 Cal.Rptr.2d 747, 1 P.3d 63, quoting Rest.2d contract, § 90, com. d, p. 244.) However, such a limitation does not preclude recovery of some measure of future income relinquished as a result of a plaintiff’s detrimental reliance. “Conceptually, promissory estoppel is distinct from contract in that the promisee’s justifiable and detrimental reliance on the promise is regarded as a substitute for consideration required as an element of an enforceable contract. There appears to be no rational basis for distinguishing the two situations in terms of the damages that may be recovered; both may involve the problem of ascertaining a future loss of profits, actually a problem of presenting adequate proof. Complete contractual recovery may include, under some circumstances, loss of profits when the loss is definite rather than speculative.” (*Signal Hill Aviation Company, Inc. v. Bill Stroppe* (1979) 96 Cal.App.3d 627, 640, 158 Cal.Rptr. 178 (*Signal Hill*)).) Because the doctrine is equitable in nature, the court should have broad judicial discretion to fashion remedies in the interests of justice. (*Ibid.*; see *C & K Engineering*, supra, 23 Cal.3d at p. 8, 151 Cal.Rptr. 323, 587 P.2d 1136.)

[¶15] The use of judicial discretion to achieve justice in a promissory estoppel case is evident in *Signal Hill*. There, in reliance on a promise to assign a lease of certain airport property, the plaintiff corporation moved onto the property and began making rental payments, repairs, and improvements. (*Signal Hill*, supra, 96 Cal.App.3d at pp. 632-633, 158 Cal.Rptr. 178.) The defendant ultimately refused to execute an assignment of the lease, and sublet the renovated airport property to others for a monthly amount far in excess of what he was required to pay under the lease. (*Id.* at p. 633, 158 Cal.Rptr. 178.) The trial court awarded the plaintiff those profits the defendant had and would receive from the lease after breach under both promissory estoppel and constructive trust theories. (*Id.* at p. 634, 158 Cal.Rptr. 178.)

[¶16] On appeal the defendant contended the “loss of profits” damage award was error because promissory estoppel damages “should be limited to those sums actually incurred by the promisee in reliance on the promise.” (Signal Hill, supra, 96 Cal.App.3d at p. 640, 158 Cal.Rptr. 178.) The Court of Appeal rejected that argument, noting that the California Supreme Court has emphasized the exercise of judicial discretion in promissory estoppel cases to fashion relief to do justice. (Ibid.) It held the net profits derived from the defendant were properly awarded “on equitable grounds” as the result of both promissory estoppel and constructive trust theories. (Id. at pp. 640-641, 158 Cal.Rptr. 178.)

[¶17] Given the equitable underpinnings of the promissory estoppel doctrine, we hold that a plaintiff such as Toscano, who relinquished his job in reliance on an unfulfilled promise of employment, may on an appropriate showing recover the lost wages he would have expected to earn from his former employer but for the defendant's promise. Under these circumstances, such a damage measure is in keeping with the equitable nature of promissory estoppel. “The object of equity is to do right and justice. It ‘does not wait upon precedent which exactly squares with the facts in controversy, but will assert itself in those situations where right and justice would be defeated but for its intervention. “It has always been the pride of courts of equity that they will so mold and adjust their decrees as to award substantial justice according to the requirements of the varying complications that may be presented to them for adjudication.” [Citation.]’ [Citation.] ‘The powers of a court of equity, dealing with the subject-matters within its jurisdiction, are not cribbed or confined by the rigid rules of law. From the very nature of equity, a wide play is left to the conscience of the chancellor in formulating his decrees. It is of the very essence of equity that its powers should be so broad as to be capable of dealing with novel conditions. [Citation.]’ [Citation.] Equity acts ‘ “in order to meet the requirements of every case, and to satisfy the needs of a progressive social condition, in which new primary rights and duties are constantly arising, and new kinds of wrongs are constantly committed.” ’ ” (Hirshfield v. Schwartz (2001) 91 Cal.App.4th at 749, 770-771, 110 Cal.Rptr.2d 861.)

[¶18] We apply the settled rule, however, that the court's damage award in these circumstances must not be speculative, remote, contingent or merely possible. (Piscitelli v. Friedenbergl (2001) 87 Cal.App.4th 953, 989, 105 Cal.Rptr.2d 88; Frustuck v. City of Fairfax (1963) 212 Cal.App.2d 345, 367-368, 28 Cal.Rptr. 357.) Analogizing to a claim for lost profits, we conclude that damages for the loss of future earnings in this context are recoverable “ ‘where the evidence makes reasonably certain their occurrence and extent.’ ” (Kids' Universe v. In2Labs (2002) 95 Cal.App.4th 870, 883, 116 Cal.Rptr.2d 158.)

[¶19] Our holding necessarily rejects the notion that the at-will nature of Toscano's former employment with Fields (undisputed by the parties here) is a strict impediment to recovery of future wages that Toscano would have earned at Fields had he not relied on Greene's promise. It is well settled that at-will contractual relations can be the subject of claims for intentional interference with contract, based on the principle that “[a] third party's ‘interference with an at-will contract is actionable interference with the contractual relationship’ because the contractual relationship is at the will of the parties, not at the will

of outsiders.” * * * * We see no reason why this principle should not extend to permit recovery of damages under the equitable theory of promissory estoppel here, where there is no dispute Greene induced Toscano to terminate his at-will employment relationship in reliance on an unfulfilled job offer. The trial court correctly concluded that under these circumstances, Toscano suffered a compensable loss at the hands of a third party. The only limitation on Toscano's recovery is that the fact and extent of his lost future earnings must be proven with reasonable certainty. * * * *

III. Toscano's Damages Are Speculative

[¶20] Code of Civil Procedure section 657, subdivision (5) provides that a verdict may be vacated or a new trial granted by the trial court for excessive damages. We conclude that even giving deference to the trial court's ruling and drawing all inferences in Toscano's favor, the evidence was too speculative to lend support to the trial court's award of Toscano's lost future earnings from September 1, 2001, to his retirement.*

[¶21] Roberta Spoon, Toscano's damages expert, testified that in calculating Toscano's lost wages for the remainder of his career, “[a]ll I have done is arithmetic. I have simply analyzed the numbers.” She testified she was not aware that Toscano's employment with Fields called for any specific tenure. Indeed, Spoon admitted Toscano could have quit or been fired from that job from the time he resigned to the present. She simply assumed Toscano would have continued employment with Fields or another employer at a comparable salary, observing that he had never in the past changed employers for anything other than a pay increase.

[¶22] Spoon's testimony does not establish Toscano had a definite expectation of continued employment with Fields for any particular period of time. Even drawing all inferences in Toscano's favor, it is evident her supposition was based only on Toscano's history of remaining with his employers until offered new employment. However, Toscano's intentions or practices are not relevant to whether he could expect to remain with Fields until his retirement, where his employment with Fields was at will. Even taking that evidence as true, evidence of Toscano's intentions does not establish with any reasonable certainty that Fields, an at-will employer who had the right to terminate Toscano at any time for any reason,[†] had some different understanding of the terms of Toscano's employment, or that it would have continued to employ him until the end of his career. Neither party presented testimony from Jerry Goldman, Toscano's boss at Fields. An expert's opinion must not be based upon speculative or conjectural data. If the expert's opinion is not based upon facts otherwise proved or assumes facts contrary to the only

* Greene conceded below and concedes here that Toscano is entitled to recover damages for one month of salary from Fields, from the date of his resignation on August 1, 2001, to his start-date with Greene, September 1, 2001.

[†] “An at-will employment may be ended by either party ‘at any time without cause,’ for any or no reason, and subject to no procedure except the statutory requirement of notice.” (Guz v. Bechtel Nat'l, Inc. (2000) 24 Cal.4th 317, 335, 100 Cal.Rptr.2d 352, 8 P.3d 1089.)

proof, it cannot rise to the dignity of substantial evidence. * * * * Although the fact of Toscano's damage was established, Spoon's conclusions as to the extent of Toscano's lost employment were wholly conjectural. We cannot ascertain with any certainty how Spoon reached her assumption as to Toscano's continued employment, particularly in view of her admission that Fields could have fired Toscano for any reason.

[¶23] The trial court further based its damages award on the fact there was “no evidence that indicates [Toscano] would have left Fields for a job which pays substantially less than he was earning there.” But as we have stated, such evidence is insufficient to support a claim of lost future income from Fields to Toscano's retirement. As a consequence, we vacate the award of Toscano's lost wages from Fields calculated from September 1, 2001, to the date of his retirement in 2017 and remand the matter for a new trial on the matter.

DISPOSITION

[¶24] The award of future earnings calculated from September 1, 2001 to the date of Toscano's retirement in 2017 is vacated and the matter remanded for a new trial on the issue of damages only. The judgment is otherwise affirmed. The parties are to bear their own costs on appeal.

Questions:

1. Can you tell what you are supposed to prove in California to win on a promissory estoppel case?
2. Why didn't Toscano sue for lost wages that he would have been paid by Greene?
3. Given the court's list of elements, would you expect expectation damages to be available for promissory estoppel? Given the court's theory as to what promissory estoppel's role is, would you expect the same?
4. Do you think restitution damages are available in promissory estoppel?
5. Toscano is not suing for out-of-pocket costs, as was Beco. How would you characterize what Toscano wants, as a general matter—what form does his reliance take?
6. Notwithstanding that the court agrees with Toscano's arguments, for the most part, why does he lose?

Note: Promissory Estoppel and Expectation Damages

Some lawyers who have read descriptions of promissory estoppel and noted its basis in reliance have believed that only reliance damages should be available as relief for it. Some courts have reached that result. *Thompson v. Schriver*, 57 Pa. D. & C. 4th 157 (2002). But most courts have rejected this view. Consider the following from *ZBS Indus., Inc. v. Anthony Cocca Videoland, Inc.*, 93 Ohio App. 3d 101 (1994):

[¶1] In the second assignment of error, ZBS argues that it was entitled to a directed verdict on Videoland's promissory estoppel claim. Specifically, ZBS contends that it is entitled to judgment as a matter of law because Videoland failed to prove its lost profit damages with sufficient certainty. The argument lacks merit.

[¶2] Lost Profits may be recovered by a plaintiff in an appropriate case where "the profits are not remote and speculative and may be shown with reasonable certainty." *Charles R. Combs Trucking, Inc. v. Internatl Harvester Co.* (1984), 12 Ohio St.3d 241, 12 OBR 322, 466 N.E.2d 883, paragraph two of the syllabus. Moreover, it has been stated that "the amounts of lost profits, as well as their existence, must be demonstrated with reasonable certainty." *Gahanna v. Eastgate Properties, Inc.* (1988), 36 Ohio St.3d 65, 521 N.E.2d 814, syllabus.

[¶3] The evidence adduced below established that ZBS agreed to supply Videoland with one thousand movies per month at a cost of \$60 per movie for a period of two years. Videoland would rent those movies for forty-five days at a fee of \$2 per day. Videoland's owner testified that, consistent with industry standards, his stores would rent the movies for at least thirty of the forty-five days, thereby recovering the full \$60 cost of the movies. The owner's testimony was supported by business consultant Don Bucci, who also stated that Videoland would recover the full cost of the movies within the forty-five-day rental period.

[¶4] At the conclusion of the forty-five-day rental period, Blockbuster agreed to purchase one thousand of the movies per month from Videoland at a cost of \$30 per movie. Under this arrangement, Videoland would earn a profit of \$30,000 per month without incurring additional expenses (\$30 per movie times one thousand movies).

[¶5] We find that the lost profits were not remote or speculative and were shown with reasonable certainty. Videoland produced sufficient evidence showing that a profit would have been realized if ZBS continued honoring the promised credit terms. Accordingly, we find that the trial court correctly denied the motion for a directed verdict on Videoland's promissory estoppel claim based on the argument that the lost profits were too speculative.

[¶6] In the third assignment of error, ZBS argues it was entitled to judgment notwithstanding the verdict, or, in the alternative, a new trial. In essence, ZBS contends that Ohio law does not permit recovery of lost profits or expectancy damages in a promissory estoppel action. The argument lacks merit.

[¶7] We agree with and adopt the following analysis of the Hamilton County Court of Appeals which appears in *Ohio Knife Corp. v. A.C. Strip* (Oct. 21, 1992), Hamilton App. Nos. C-910482 and C-910488, unreported, 1992 WL 308365, regarding the recovery of damages in a promissory estoppel action:

"In general, the law of contract recognizes three compensable interests: a restitution interest, a reliance interest, and an expectation interest. We are concerned here with only the latter two. As stated by Calamari and Perillo: 'The reliance interest represents the detriment [the promisee] may have incurred by changing his position. The expectation interest represents the prospect of gain from the contract.' Calamari and Perillo, *Contracts* (2 Ed.1977) 522, Section 14-4. The availability of both expectancy and reliance damages in a promissory-estoppel action was discussed by the court in *Mers v. Dispatch Printing Co.* (1988), 39 Ohio App.3d 99, 105, 529 N.E.2d 958, 966. A damage award in a promissory estoppel claim can be based upon either reliance damages or expectancy damages. 1A Corbin, *Corbin on Contracts* (1963) 221, Section 200. The remedy should depend on what justice requires in a particular case. Factors to be considered are the definiteness in measuring the damages caused by the reliance and whether the promise relied upon obligates the promisor into the future. 1A Corbin, *Corbin on Contracts* (1963) 221, Section 200, 240-241, Section 205." See, also, *Evets Elec., Inc. v. Ohio Edison Co.* (Dec. 20, 1991), Trumbull App. No. 89-T-4289, unreported, 1991 WL 274243; *Pieper v. Gunderman* (Sept. 16, 1991), Paulding App. No. 11-90-15, unreported, 1991 WL 216786.

Consistent with the above-cited authority, we find that a plaintiff may recover expectancy damages, including lost profits, in a promissory estoppel action where, as here, the promise relied upon obligates the promisor into the future and those damages are demonstrated with reasonable certainty.

Here are a few more examples of courts' granting expectation damages for promissory estoppel:

(1) The court enforced a promise of a pension (in reliance on which the promisee had retired) in *I.G. Katz v. Danny Dare, Inc.*, 610 S.W.2d 121 (Mo. App. 1981). The remedy was to order the pension paid. Consider that a promise of a pension induces an employee to give up a job at which wages in excess of the pension amount could have been earned; the expectation measure is the lower of (i) the amount of the pension and (ii) the lost opportunity of wages the former employee would have earned had he not retired. Expectation was the most just measure, in that case.

(2) In *Walters v. Marathon Oil Co.*, 642 F.2d 1098 (7th Cir. 1981), the court granted expectation damages to remedy breach of an oil company's promise to supply gasoline to a potential station owner during the Arab Oil Embargo. The only reason the Walters did not sue on a contract is that Marathon put a moratorium on all new agreements days before the parties were to sign. This was after the Walters had, in reliance on Marathon's promises, bought the station property and prepared it. Under the supply agreement, the costs of preparing and running the station were allocated to the Walters, so out-of-pocket costs was not a proper measure of damages. Instead, the court noted that the Walters had foregone the opportunity to invest elsewhere. The court suggested that the lost profits from the station was a proper measure of the value of those lost opportunities. The decision is thus consistent with both expectation and reliance.

Each promissory estoppel case must be taken individually, just as each contract case.

4. Restitution

David O. JOHNSON v. John W. BOVEE and Alice M. Bovee
Colo. App. (1978), 574 P.2d 513

PIERCE, J.

[¶1] Plaintiff, David O. Johnson, doing business as David O. Johnson Construction Company, appeals a judgment of the trial court entered in his favor and against John and Alice Bovee, arguing that the court erred in its measure of damages. We disagree, and affirm the judgment in its entirety.

[¶2] The Bovees and Johnson entered into a written contract under which Johnson agreed to build a house for the Bovees according to a specified set of plans, in exchange for a contract price of \$47,176. During the course of the house's construction, Johnson and the Bovees orally agreed to many deviations from the original plans—resulting in both additions ("extras") and deletions.

[¶3] The Bovees became dissatisfied with the quality of the construction. They then stopped making payments to Johnson and his suppliers, payments which were required under the contract. Johnson therefore stopped working on the house, and filed this suit to foreclose on his mechanic's lien. The Bovees, who finished the house, counterclaimed for the costs of repairing the defective workmanship.

[¶4] The trial court found that Johnson had substantially performed his obligations under the contract and therefore that the Bovees' refusal to make payments constituted a breach. It also found that the house was 90% complete when construction stopped. The damages awarded to Johnson were based on the contract price and were calculated in the following manner:

Contract price \$47,176.00
Net value of the agreed extras 7,700.78
Payments made by the Bovees -49,485.18
Cost to Johnson had he completed the house (10% of \$47,176) - 4,717.60
TOTAL: \$ 674.00

[¶5] The court awarded the Bovees \$2,427.55 on their counterclaim for remedial work. Johnson does not dispute the trial court's factual findings upon which these calculations were based. Rather, he argues that he is entitled to recover in quantum meruit for the reasonable value of the services he rendered which he claims to be \$9,000 over the original contract price and agreed extras.

[¶6] We are therefore faced with the issue of whether restitution can be recovered in an amount in excess of the contract price, an issue which is a matter of first impression in Colorado.

[¶7] We note at the outset that Johnson is not precluded from seeking restitution merely because his original complaint stated a claim for breach. If the evidence justifies an award of restitution, the particular theory pled will not prevent the award. *Reynolds v. Armstead*, 166 Colo. 372, 443 P.2d 990 (1968). See C.R.C.P. 54(c).

[¶8] Since the Bovees breached the contract by refusing to make the required payments, Johnson was entitled to consider the contract a nullity, and recover the reasonable value of his services. See, e. g., *Jacobs v. Jones*, 161 Colo. 505, 423 P.2d 321 (1967); *Zion Baptist Church v. Hebert*, 94 Colo. 59, 28 P.2d 799 (1933). But none of the cases supporting this principle involved a contractor who had overspent and was asking for more than the contract price.

[¶9] Courts and commentators are divided over the question of whether restitution should be limited by the contract. Compare *Palmer, The Contract Price as a Limit on Restitution for Defendant's Breach*, 20 *Ohio State L.J.* 264 (1959) with *Childres & Garamella, The Law of Restitution and the Reliance Interest in Contract*, 64 *Nw. U.L.Rev.* 433 (1969). For a survey of arguments on both sides of this issue, see *D. Dobbs, Law of Remedies*, § 12.1 at 794-795 (1973).

[¶10] We believe using the contract price as a ceiling on restitution is the better-reasoned resolution of this question. Had Johnson fully performed, his recovery would be limited to the contract price, since he would be suing for specific performance of the liquidated debt obligation under the contract. See 5 *A. Corbin, Contracts*, § 1110 (1964). It is illogical to allow him to recover the full cost of his services when, if he completed the house, he would be limited to the contract price plus the agreed upon extras.

Accordingly, the judgment of the trial court is affirmed.

COYTE and ENOCH, JJ., concur.

Note: Not all courts are so limiting. Consider the following from *Salo Landscape & Constr. Co., Inc. v. Liberty Elec. Co.*, 119 R.I. 269, 274 (1977):

There remains only the question of the proper measure of plaintiff's recovery for the work done. The theory urged by plaintiff and adopted by the trial justice is that defendant's failure to make the agreed upon progress payments constituted a total breach of the substituted contract and entitled plaintiff to recover the reasonable value of the work performed rather than damages based on the contract price. In support of its claim under that theory, plaintiff presented testimony that the fair and reasonable value of the performance rendered was \$26,644.79. The defendant, on the other hand, argues that plaintiff had agreed in its subcontract that its compensation was to be based upon the unit price schedule stipulated in defendant's contract with the Commonwealth and that its damages should therefore be limited to a sum arrived at by multiplying the units of work completed by the prices stipulated therefor. That sum, according to defendant, is only \$14,436.87.

The defendant's theory falls short and plaintiff's hits the mark, however, for an owner or prime contractor who fails to pay an installment due on a construction contract is guilty of a breach that goes to the essence of the contract and that entitles the injured party to bring an action based on a quantum meruit theory for the fair and reasonable value of the work done. *Pelletier v. Masse*, 49 R.I. 408, 410-11, 143 A. 609, 610 (1928); *Greene & Brown v. Haley*, 5 R.I. 260, 262 (1858); Restatement, Contracts § 347 (1932); 5 Corbin, *supra* § 1109. The plaintiff in this case has brought such an action; and defendant, having offered no evidence suggesting that plaintiff's claim is not a fair and reasonable charge for the work done, has given us no reason for disturbing the trial justice's acceptance of that claim.

Why would you do one or the other?

C. Limiting Doctrines

1. Speculation

COLUMBIA PARK GOLF COURSE, INC. v. CITY OF KENNEWICK
Wash. App. (2011), 160 Wash. App. 66

OPINION PUBLISHED IN PART

[¶1] We are asked in this case to set aside a jury's damage award to Columbia Park Golf Course Inc. (Columbia) following trial of its claims against the city of Kennewick (City) for breach of a development option agreement and the implied covenant of good faith and fair dealing. The City does not appeal the jury's determination that it breached the agreement but contends that the damages awarded were not recoverable as a matter of law, principally because at the time of the breach Columbia had not secured the permits, approvals, and agreements needed to succeed and because it characterizes the damages as future profits from a new business. The City also argues instructional error and that the trial judge should have ordered remittitur. We agree with the trial judge that Columbia presented substantial evidence in support of its claims and was entitled to submit its claim for presently measurable damages, not lost profits, to the jury. The trial court did not err in instructing the jury and substantial evidence supports the verdict. We affirm.

FACTS AND PROCEDURAL BACKGROUND

[¶2] The federal government owns Columbia Park, 363 acres of recreational property located along the Columbia River shoreline. Federal ownership arose with construction of the McNary Lock and Dam, which created a reservoir whose shorelines are administered by the Secretary of the Army and the Army Corps of Engineers (Corps). The Secretary leased the park and other shorelines to Benton County, mandating that they be used for park and recreational purposes. After property comprising [sic] the park was annexed by the City, the Corps terminated its lease to Benton County and entered into a 50-year lease to the City. The Corps' master lease agreements with local governments require the governments and their sublessees to administer Corps property for park and recreational purposes, guided by an annual plan proposed by the local government and agreed to by the Corps. Among uses for the park that have been deemed suitable by the Corps for many years are as a golf course, as an overnight campground, and as a marina.

[¶3] After the City acquired an interest in the park, it adopted development plans. A master development plan approved and adopted by the city council in February 2000 was controlling during all periods relevant to Columbia's claims. The master development plan was arrived at through a public process and was used as a guideline for decision-making about the park. The 2000 master development plan described a golf course and driving

range that had long existed in the east end of the park, as well as plans for expanding and improving the course and course facilities.

[¶4] Prior to 2000, city employees operated the golf course and driving range. In the late 1990s, the City issued a request for qualifications seeking a private “partner” to undertake improvements and privatize course operations. Columbia's controlling shareholder and president, Gary Long, Jr., submitted a proposal on its behalf. Mr. Long's background included management of retail golf stores, pro shops, driving ranges, and miniature golf courses. Mr. Long was also part owner of a software company that offered sales accounting and tracking software for golf course and food and beverage operations, including for golf course resorts offering recreational vehicle (RV) camping.

[¶5] Columbia was selected by the City to be the developer and operator of improved golf course operations. In March 2000, the City and Columbia executed a 25-year sublease, which included an option to renew for 5 years. The property included in Columbia's sublease included the golf course, driving range, other itemized buildings and facilities, and additional property east and west of existing operations. For the first five years of the sublease, the parties agreed that Columbia would make \$50,000 in capital improvements annually, in lieu of rent.

[¶6] By September 2001, Columbia had constructed over \$300,000 worth of improvements and decided it wanted to construct a larger clubhouse and restaurant than originally envisioned. It approached the City with revised plans and a request for lease modifications in its favor, to compensate for its increased investment. The City agreed to extend the term of the sublease through September 2031 with options running to January 2050, and to extend the period for capital improvements in lieu of rent to 10 years. It also agreed that Columbia would own any new improvements and to revise the assignment clause to make Columbia's rights more freely assignable. An addendum reflecting these changes was executed in April 2003 and approved by the Corps.

[¶7] Columbia then encountered problems designing the larger building, given site constraints and difficulties relocating the driving range. Mr. Long was working through the driving range problems with city staff when he became interested in a second development opportunity in the park.

[¶8] West of the golf course in the park was an old campground. The Corps' 1982 plan for the park identified the campground location as a problem, since physical constraints imposed by a levee resulted in a roundabout access route making the campground hard to find. By 2003 the amenities were outdated, the campground had lost money under city operation, and it had to be closed due to an inadequate septic system. The City's 2000 master development plan stated, with respect to the campground, that a “relocated recreational vehicle (RV) campground shall be designed, built and operated by a private owner on a long-term lease from the City” and in April 2004, the City published a request for qualifications seeking a qualified “partner” to design, construct, and operate a new RV

campground. Ex. 1-M (Ex. C at 00038); Ex. 1-L. It received only one proposal, which was nonresponsive. At that point the City began exploring its own development of a campground, and favored finding a different location in the park.

[¶9] In February 2005, Mr. Long, having heard of the lack of response, approached the City's director of parks and recreation, Cindy Cole, and expressed interest in submitting a proposal. He assumed the RV park would remain at the former campground location, but soon learned from Ms. Cole that the City preferred to move it. He was keenly interested in the potential of a resort-type RV park as part of the golf course redevelopment, if the City would agree to an RV park replacing the existing driving range. Columbia's leasehold was zoned open space and designated open space under the City's comprehensive plan, thereby allowing development of an RV park. Ms. Cole and other city staff believed the proposal had merit and city staff encouraged Mr. Long to include moorage for overnight boater camping. City staff began working with Mr. Long on the concept and design of an RV park, shoreline improvements, and boat moorage at Columbia's existing leasehold.

[¶10] By August 2005, Columbia had prepared and provided the City with an initial development plan, and Columbia and the City entered into a development option agreement (DOA) “for the purpose of granting an exclusive option for the development of a recreational vehicle park, shoreline improvements and boat moorage within Columbia Park.” Ex. 1-AA at 1. The agreement recognized Columbia's desire to “protect its substantial investment in the feasibility plan” and promised that during the term of the agreement the City would not “entertain or negotiate any alternate proposals for development of a recreational vehicle park, shoreline improvements, and boat moorage within Columbia Park.” Id. at 1, 2. The DOA required Columbia to provide a project site plan, pursue site plan approval, and, upon final site plan approval, construct the development. The term of the DOA was six months, with options to extend. Through later exercise of the options, the agreement remained in effect through February 15, 2007.

[¶11] The Corps indicated support for the revised development plan. Mr. Long and Ms. Cole had a predevelopment meeting with representatives of the Corps in September 2005 and Corps representatives confirmed that they considered campgrounds a normal shoreline use and even agreed to consider the RV park for a pilot program that would allow greater-than-30-day stays. A city staff report thereafter prepared for the planning commission stated that “the Corps of Engineers have expressed support of this project as a recreational use.” Ex. 2-GG at 10684.

[¶12] City staff and officials indicated support for the project. Columbia engaged engineers and submitted an application under the State Environmental Policy Act (SEPA), chapter 43.21C RCW, to the City in September 2005 and an application for a shoreline substantial development permit and attached site plan in October 2005. City staff found that the RV park proposal met the intents and goals of the City's master development plan and the criteria established in the plan for an RV park, and recommended that the City's parks and recreation commission approve it with identified conditions. The parks and

recreation commission voted to recommend approval of the permit application on March 9, 2006.

[¶13] Notice of the application and the City's likely issuance of a mitigated determination of nonsignificance under SEPA was mailed to involved agencies and affected property owners on March 29, 2006. Only one letter of concern from a competing RV park owner was received by the end of the comment period.

[¶14] The planning commission considered the permit application and City recommendation on April 17. The competing RV park owner who had submitted written opposition was the only citizen who spoke in opposition, objecting to lengths of stay longer than 30 days. Members of the planning commission nonetheless voted to recommend denial of the shoreline application.

[¶15] The city council rejected the planning commission's recommendation and approved the shoreline permit at a May 2, 2006 meeting. Although the competing RV park owner and six other individuals spoke against the project, the council's Resolution 06-14, to approve the shoreline permit, passed 5-2. The permit issued by the City authorized Columbia “[t]o undertake the following development: Renovations to the existing Columbia Park Golf Course, which includes removal of the existing driving range, and an expansion within the current lease area that will include an RV Park/Campground.” Ex. 2-NN at 10655.

[¶16] Opponents of the shoreline permit had 30 days within which to appeal approval of the permit to the Department of Ecology, during which time Mr. Long was notified Columbia could take no action on construction. Mr. Long's intended next step (following the appeal period) was to seek a building permit. No one appealed approval of the shoreline permit.

[¶17] In the meantime, and during the eight months between Columbia's filing of its SEPA application and shoreline application approval, another development proposal was presented to the City. In November 2005, city representatives met with Aaron Beasley, representing Tri-River Sports Facilities Inc. (Tri-River Sports), who proposed to develop portions of the park located in the cities of Kennewick and Richland as a multipurpose community center, to include an RV park and boat docks. At the time of Mr. Beasley's December 2005 meeting with officials of the City and Richland, he projected revenues for the first year of \$22 million, increasing to \$25.5 million by 2008.

[¶18] Tri-River Sports and the City entered into their own development option agreement (Tri-River Sports DOA) in February 2006. By the terms of that DOA, Tri-River Sports agreed to develop a site plan for a multipurpose community center in the west end of the park and the City agreed not to entertain alternate proposals for a multipurpose community center in that area.

[¶19] Evidence at trial revealed that the City recognized as early as November 2005 that its dealings with Tri-River Sports were or might be inconsistent with the promises made in the Columbia DOA. In early May 2006, about a week after the council approved Columbia's shoreline management permit, city attorney John Ziobro sent a memo to city manager Bob Hammond addressing the City's obligations under the DOA. While the memo can be, and was, characterized by the City as a good faith assessment of the City's legal obligations to Columbia, it can also be, and was, characterized by Columbia as a veiled road map to actions which, if taken, could prevent Columbia's proposed development from coming to fruition. Among actions identified by the memo that would prevent completion of an RV park by Columbia were to (1) refuse to extend the development option agreement, which would open the door to competition from another developer (arguably referring to Tri-River Sports); (2) give Columbia notice before sublease negotiations that the City is concerned about the project; or (3) propose new lease terms.

[¶20] Approximately a month after the council approved Columbia's shoreline permit and several weeks after Mr. Ziobro's memo, Mr. Hammond requested a meeting with Mr. Long, at which he, the mayor, and other city officials told Mr. Long and two of his investors that the RV park was “ ‘just not going to happen’ ” in Columbia's existing leasehold. Report of Proceedings (RP) at 184. Mr. Long later testified that the announcement left him “numb.” RP at 186. He asked Mr. Hammond whether the City's position had anything to do with Tri-River Sports. According to Mr. Long, Mr. Hammond deflected the question but at the same time insisted that “ ‘we're pretty good at solving problems.’ ” Id. At a city council meeting that night, the council voted to discontinue consideration of an RV park in Columbia's existing leasehold, but indicated the City's willingness to explore Columbia's development of an RV park at another location.

[¶21] On June 13, Tri-River Sports presented its park development proposal to the joint city councils of the City and Richland, including a scale model and a video showing an RV park and boat moorage. Following the meeting, the scale model of the proposed Tri-River Sports development was placed on display in the lobby of the Kennewick City Hall.

[¶22] For a number of months thereafter, Columbia and the City attempted to negotiate development of an RV park and restaurant at locations west of the golf course, including locations Mr. Long viewed as desirable. But siting the RV park at a location other than Columbia's existing leasehold required entry into a new lease-and terms could never be reached, for reasons that were disputed. At trial, Mr. Hammond could not recall any particular disagreements that prevented lease of another location to Columbia, other than to say that upon consulting with Mr. Ziobro and other city staff, he believed lease terms expected by Columbia were “too sweet” for the City to consider legal. RP at 581. Columbia contended that city staff intentionally held out for onerous lease terms in an effort to avoid a conflict with Tri-River Sports by killing any deal with Columbia.

[¶23] During the period Columbia attempted to negotiate for a location west of the golf course, the City continued to correspond internally over its legal exposure. Among exhibits

admitted at trial was an October 2006 memo from Mr. Ziobro to Mr. Hammond and Russ Burtner, the City's executive director of municipal services, addressing Tri-River Sports' legal demands and threats, in which Mr. Ziobro observed that Tri-River Sports appeared unwilling to engage in a resolution that would allow Columbia to locate an RV park or restaurant in the west end of the park. Mr. Ziobro opined in the memo that "[i]n some respects, the [Columbia] Agreement is the stronger of the two Agreements," and stated that "[i]t very well could be that the City breached [Columbia's] Agreement by entering into the Tri-River Agreement." Ex. 3-S at 7, 2. But he also noted that, as compared to the threats being made by Tri-River Sports, "there does not appear to be the same imminent threat of litigation with the [Columbia] group." Id. at 7.

[¶24] In January 2007, city staff recommended that the city council deny Columbia's next request for extension of its DOA. In response, Columbia withdrew its request for an extension of the agreement and filed suit against the City in February 2007.

[¶25] In its complaint filed in Benton County, Columbia alleged that the City breached the DOA and its duties to Columbia in two ways: by entertaining the Tri-River Sports project in violation of the exclusivity provision, and by revoking its agreement that Columbia could construct an RV park within its existing leasehold. It asserted contract, tort, and restitution theories, as well as a claim under 42 U.S.C. § 1983. [The City removed the case to federal court, which dismissed the tort claims without prejudice and dismissed Columbia's federal and restitution claims. The federal court then remanded the case to state court.]

[¶26] Following remand the City again moved for summary judgment dismissing Columbia's complaint, and the state court, like the federal court, refused to dismiss the contract claims.

[¶27] The contract claims were tried to a jury over 10 days in June 2009. By special verdict, the jury found that the City breached the DOA and the covenant of good faith and fair dealing. The jury awarded Columbia damages of \$3 million. The City's motion for judgment as a matter of law, a new trial, or remittitur of the damages amount was denied, and this appeal timely followed.

ANALYSIS

[¶28] The pivotal issue on appeal is damages. While the City contested Columbia's claim that it breached the DOA and its duty of good faith and fair dealing, it confines its appellate challenge to issues bearing on the substantial damage award. * * * *

I. Recovery of Damages, Including Expectation Damages

[29] The City contends that damages based on the development contemplated by the DOA were not recoverable as a matter of law because Columbia never secured, and the Corps therefore never approved, a modified sublease substituting a right to operate an RV park for Columbia's original obligation to operate a driving range. The City moved on this basis for summary judgment dismissal of Columbia's contract claims, later for a directed verdict and, following the jury's verdict, for judgment as a matter of law. Ordinarily we will not review an order denying summary judgment after a trial on the merits, but “we will review such an order if the parties dispute no issues of fact and the decision on summary judgment turned solely on a substantive issue of law.” *Univ. Vill. Ltd. Partners v. King County*, 106 Wash.App. 321, 324, 23 P.3d 1090, review denied, 145 Wash.2d 1002, 35 P.3d 381 (2001). The City's challenge on appeal is only to the trial court's decision on this issue of law. Reply Br. of Appellant at 6.

[¶30] We review issues of law de novo. * * * *

Evidence of City and Corps Agreement to Substitute Operation of an RV Park for the Driving Range

[¶31] Columbia's principal response to the City's argument is that the City and Corps had, by words and action, already approved modification of its sublease to allow development of an RV park. We agree there was evidence from which the jury could find that while further design and construction approvals would be needed from the City and the Corps, no further modification of the sublease was required. * * * *

[¶32] When viewed in the light most favorable to Columbia, there was substantial evidence from which the jury could find that until the council announced in June 2006 that it would no longer allow the RV park to be located within Columbia's existing leasehold, the City and the Corps had agreed to the substitution, subject to Columbia's satisfaction of terms and conditions in the DOA.

Availability of Damages for Breach of a “Contract to Negotiate”

[¶33] Because Columbia sued for breach of the DOA, not the sublease, the status of agreement on the sublease was not a basis for foreclosing damages entirely—even if it might be relevant to the nature and extent of damages caused by the City's breach of the DOA. Generally, a party injured by breach of contract is entitled (1) to recovery of all damages that accrue naturally from the breach and (2) to be put into as good a pecuniary position as he would have had if the contract had been performed. *Eastlake Constr. Co. v. Hess*, 102 Wash.2d 30, 39, 686 P.2d 465 (1984) (citing *Diedrick v. Sch. Dist. No. 81*, 87 Wash.2d 598, 610, 555 P.2d 825 (1976)). To recover, the plaintiff has the burden of proving that the defendant breached the contract, that the plaintiff incurred actual economic damages as a result of the breach, and the amount of the damages. * * * * Damages are not

recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty. *Kadiak Fisheries Co. v. Murphy Diesel Co.*, 70 Wash.2d 153, 167, 422 P.2d 496 (1967).

[¶34] Preliminarily, we note that the trial judge found the DOA to be a “contract to negotiate,” as that term is used in *Keystone*, 152 Wash.2d at 171, 94 P.3d 945. CP at 4895-96. The damages recoverable for breach of a contract to negotiate is an undecided issue in Washington. In *Keystone*, our Supreme Court answered certified questions whether Washington contract law recognized and would enforce an agreement to negotiate a future contract and, if so, what would be the proper measure of damages for breach. The court provided an answer only to the first question, specific to the facts of the *Keystone* case. The court declined to reach the question of damages, which it and the Ninth Circuit Court of Appeals (the federal appellate court had certified the questions) implicitly recognized as an open one. See *Keystone Land & Dev. Co. v. Xerox Corp.*, 353 F.3d 1093, 1098 (9th Cir.2003).

[¶35] The City cites no authority for its position that ordinary contract damage principles do not apply and that the trial judge should have denied damages entirely and dismissed Columbia's claim. While some jurisdictions have limited damages recoverable for breach of a contract to negotiate, we have identified none that have foreclosed damages entirely where a breach has been established.

[¶36] Those jurisdictions that limit damages for breach of a contract to negotiate restrict a plaintiff to reliance damages, on the basis that there can be problems of proof as to the fact or amount of expectation damages. Cf. Restatement (Second) of Contracts § 352, cmt. a, § 349, illus. 1, 2, and 3 (1981) (when a plaintiff is unable to prove expectation damages with reasonable certainty, it may recover loss based on its reliance interest). But we find no basis in Washington law to adopt a special rule that always forecloses the usual expectation measure of damages—essentially a conclusive presumption that expectation damages can never be proved with reasonable certainty—when a longstanding “reasonable certainty” requirement already guards against speculative awards. * * * *

[¶37] Better reasoned authority from other jurisdictions supports applying usual contract principles, recognizing that where there is not reliable evidence of a final agreement (or, as in this case, the final project) a plaintiff might be unable to prove expectation damages with the required certainty and be left to reliance damages. In *Venture Associates Corp. v. Zenith Data Systems Corp.*, 96 F.3d 275, 278-79 (7th Cir.1996), Judge Posner explained why a plaintiff should—depending on the evidence—be entitled to recover damages measured by the final agreement contemplated by the parties:

Damages for breach of an agreement to negotiate may be, although they are unlikely to be, the same as the damages for breach of the final contract that the parties would have signed had it not been for the defendant's bad faith. If, quite apart from any bad faith, the negotiations would have broken down, the party led on by the other party's bad faith to persist in futile negotiations can recover only his

reliance damages—the expenses he incurred by being misled, in violation of the parties' agreement to negotiate in good faith, into continuing to negotiate futilely. But if the plaintiff can prove that had it not been for the defendant's bad faith the parties would have made a final contract, then the loss of the benefit of the contract is a consequence of the defendant's bad faith, and, provided that it is a foreseeable consequence, the defendant is liable for that loss—liable, that is, for the plaintiff's consequential damages. The difficulty, which may well be insuperable, is that since by hypothesis the parties had not agreed on any of the terms of their contract, it may be impossible to determine what those terms would have been and hence what profit the victim of bad faith would have had. But this goes to the practicality of the remedy, not the principle of it.

(Citations omitted.) The weight of authority from other jurisdictions is in accord. See *Logan v. D.W. Sivers Co.*, 343 Or. 339, 169 P.3d 1255, 1265-66 (2007) (Kistler, J., concurring in part and dissenting in part) and cases cited therein. Even more so is the trend of authority. Professor E. Allan Farnsworth, whose treatise on contracts and other publications were once relied upon as authority for rejecting expectation damages in cases such as this, later changed his position. *Logan*, 169 P.3d at 1266 nn. 5, 6.2 ; and see *Fairbrook Leasing, Inc. v. Mesaba Aviation, Inc.*, 519 F.3d 421, 429 (8th Cir.2008) (questioning whether expectation damages would be foreclosed in a jurisdiction generally foreclosing expectation damages “if it can be discerned what agreement would have been reached”).

[¶38] Under Judge Posner's analysis, the alternative reliance damage measure would be used only “[i]f, quite apart from [the breach], the negotiations would have broken down.” *Venture Assocs.*, 96 F.3d at 278. In the trial below, however, the City staked its defense on nothing more than the theoretical possibility that agreement on development would have broken down, while Columbia presented substantial evidence that until the Tri-River Sports opportunity became a distraction, the path to its project completion appeared clear and problem-free. It has been argued that if a party wants to avoid paying expectation damages on the basis that final agreement was unlikely, it should offer evidence of that unlikelihood. Professor Eisenberg, discussing an explicit contract to negotiate in good faith, states:

Where such a commitment is part of a bargain, the injured party should be awarded expectation damages. Of course the deal might have broken down even if the other party had negotiated in good faith. However, because that party's wrongful acts made it impossible to determine what would have happened if she had acted in good faith, she should bear the burden of proving the deal would have broken down even if she had so acted.

Melvin Aron Eisenberg, *The Emergence of Dynamic Contract Law*, 88 Cal. L.Rev. 1743, 1809 (2000).

[¶39] A rule depriving parties like Columbia of the customary measure of damages ignores the reasonable motivation of contracting parties and is likely to discourage qualified parties from entering into development agreements with local governments in

Washington. The purpose of damages in a breach of contract action is “ ‘not the mere restoration to a former position, as in tort, but the awarding of a sum which is the equivalent of performance of the bargain—the attempt to place the plaintiff in the position he would be in if the contract had been fulfilled.’ ” *Rathke v. Roberts*, 33 Wash.2d 858, 865, 207 P.2d 716 (1949) (emphasis omitted) (quoting *McCormik on Damages* 560, § 137). It is hard to conceive of a talented developer who would agree to invest meaningful capital and effort into an 18-month or longer project knowing that the local government had a right to breach with impunity at any time and compensate the developer with nothing more than reliance damages. A development partner willing to do business on those terms is probably not a development partner worth having. A local government concerned about unpredictable liability can negotiate a cancellation fee of the sort often agreed in the private sector, ensuring the developer some premium if the project is abandoned but capping the local government's exposure should there later be good reasons to terminate a project or relationship. See *Sierra Club v. Franklin County Power of Ill., LLC*, 546 F.3d 918, 934 (7th Cir.2008) (quoting *Venture Assocs.*, 96 F.3d at 278).

[¶40] Damages in this case were properly determined by the jury. The constitution consigns to the jury the ultimate power to weigh the evidence and determine the facts, and the amount of damages in a particular case is an ultimate fact. *James v. Robeck*, 79 Wash.2d 864, 869, 490 P.2d 878 (1971). Whether a plaintiff has proved his loss with sufficient certainty is likewise generally a question of fact. In the context of a contract to purchase, the Washington Supreme Court has held, “ ‘It is often said that, once the buyer establishes the fact of loss with certainty (by a preponderance of the evidence), uncertainty regarding the amount of loss will not prevent recovery. Thus, a buyer will not be required to prove an exact amount of damages, and recovery will not be denied because damages are difficult to ascertain.’ ” *Lewis River Golf, Inc. v. O.M. Scott & Sons*, 120 Wash.2d 712, 717-18, 845 P.2d 987 (1993) (quoting *Anderson, Incidental and Consequential Damages*, 7 J.L. & Com. 327, 395-96 (1987) for this “accepted rule of law”).

[¶41] The trial judge properly denied the City's several motions to dismiss Columbia's claims.

II. Reasonable Certainty and the “New Business Rule”

[¶42] The real issue that loomed for Columbia in this case, particularly where the RV park and restaurant could be characterized as a new business, was whether damages from hoped-for future operations were too speculative. The “new business rule” ordinarily prevents an unestablished business from recovering lost profits as damages for breach. *Kaech v. Lewis County Pub. Util. Dist. No. 1*, 106 Wash.App. 260, 276, 23 P.3d 529 (2001), review denied, 145 Wash.2d 1020, 41 P.3d 485 (2002). Profits for a new business are generally “ ‘too speculative, uncertain, and conjectural to become a basis for the recovery of damages.’ ” *Id.* (quoting *No Ka Oi Corp. v. Nat'l 60 Minute Tune, Inc.*, 71 Wash.App. 844, 849, 863 P.2d 79 (1993), review denied, 124 Wash.2d 1002, 877 P.2d 1287 (1994)). Such damages may be recovered, however, if a reasonable estimate can be

made by analyzing market conditions and profits of substantially similar businesses. *Farm Crop Energy*, 109 Wash.2d at 928, 750 P.2d 231.

Nature of Columbia's Damage Claim

[¶43] Evidently recognizing a risk, Columbia elected to forego any claim for lost profits. Instead, it contended that the bundle of rights it had acquired by the time of the City's breach (its 50-year lease, its shoreline permit, its approved site plan, and its exclusivity agreement, all associated with an exceptional recreational property) was assignable and that a market existed for such development rights. Columbia asked the jury to award it the market value of this asset it claimed was destroyed. The 2003 addendum to the sublease supported Columbia's position, since it reflected a modification making it easier for Columbia to sell and assign its rights, and even required a substantial payment to the City in the event Columbia assigned those rights prior to 2013.

[¶44] The way Columbia valued the asset—by applying a discount rate to its projected profits and arriving at a price that an investor would pay—parallels the method by which it would have proved lost profits, to be sure.* But while a “lost asset” measure may still be challenged as insufficiently certain to be submitted to the jury, it is more likely to survive the challenge because it is more susceptible to cross-examination and reliable countervailing evidence: it exists in a market, at a known point in time. With a lost asset damage claim, the City was not required to challenge facts hypothesized to exist decades after the 2009 trial; it could challenge whether the alleged market for golf course opportunities existed at the time of the alleged breach in 2006 and, if it did, whether investors in that market would accept Columbia's projections as sufficiently reasonable and reliable, and whether they would arrive at a proposed price using the discount rate that Mr. Long testified was market.† Under the lost asset theory of damage, it is irrelevant whether Mr. Long's pro forma financial projections would have proved correct; what matters is only whether a market existed and whether a \$2.5 to \$3 million price would have been paid for the bundle of rights in that market. This is a distinction with a difference, and one that enables an injured party who holds a bundle of rights for which a market exists to avoid a “lost profits” problem by subjecting its damage measure to measurement, cross-examination, and countervailing evidence available at the time of trial. See, e.g., *Schonfeld v. Hilliard*, 218 F.3d 164 (2d Cir.2000); *First Fed. Lincoln Bank v. United States*, 518 F.3d 1308 (Fed.Cir.2008); and cf. Restatement, *supra*, § 348(3) & cmt. d (If a breach is of a promise conditioned on a fortuitous event and it is uncertain whether the event would have occurred had there been no breach, the injured party may recover damages based on the

* Washington cases accept capitalized net operating income using a market-derived discount rate as a measure of market value of an asset. * * * *

† The financial projections relied upon by Mr. Long for his damage figure were not created for the litigation, they had been prepared prior to entry into the DOA and had been requested by the City to assess whether Columbia's proposed RV gold project was viable. Mr. Long's projected earnings supporting his \$2.5 to \$3 million damage figure were far less than the revenue that the jury heard was projected by Tri-River Sports for the Tri-River project.

value of the conditional right at the time of the breach. The value of that right must itself be proved with reasonable certainty, as it may be if there is a market for such rights.).

Alleged Instructional Error

[¶45] The City nonetheless assigns error to the trial court's refusal to instruct on the “new business rule” as a limitation on the recovery of lost profits. The City proposed three instructions: its originally proposed instructions D-14 and D-15 and an unnumbered alternative later submitted with a pocket brief. CP at 4985-86, 5141. However, the City's proposed instruction D-14 foreclosed any award of net profits, even if reasonably certain. Its proposed D-15 and the alternative submitted with its bench brief both required testimony by an expert witness as a condition to recovery—testimony that Columbia did not present and that is not required by Washington law. *Tiegs v. Watts*, 135 Wash.2d 1, 954 P.2d 877 (1998) (testimony and exhibits offered by and through the plaintiffs, experienced operators, provided a reasonably certain basis for a lost profits damage claim).

[¶46] A court is not required to give an instruction that is erroneous in any respect or where it is reasonably possible to misstate the law. *Tennant v. Roys*, 44 Wash.App. 305, 310, 722 P.2d 848 (1986). And where Columbia was not seeking lost profits, the giving of any instruction on profits as damages would indicate to the jury that the trial judge thought there was evidence on the issue and that limitations applicable to lost profits claimed by a new business should apply. Washington cases consistently hold that it is prejudicial error to submit an issue to the jury when there is no substantial evidence concerning it. *Albin v. Nat'l Bank of Commerce of Seattle*, 60 Wash.2d 745, 754, 375 P.2d 487 (1962).

[¶47] The trial judge's proper instructions allowed the City to argue that Columbia was not entitled to recover speculative or conjectural damages. His instruction on the measure of damages limited recovery to “actual damages,” defined as “those losses that were reasonably foreseeable, at the time the contract was made, as a probable result of a breach,” and he instructed that in calculating damages, the jury “should determine the sum of money that will put [Columbia] in as good a position as it would have been in if both [parties] had performed all of their promises under the contract.” CP at 5185-86 (Instruction 25). The trial judge did not abuse his discretion in rejecting the City's erroneous and prejudicial proposed instructions.

[¶48] The judgment is affirmed.

[SIDDOWAY, J., concurring:]

[¶49] The argument for reliance damages is that they make the nonbreaching party whole and avoid speculative claims for damages. *Copeland v. Baskin Robbins U.S.A.*, 96 Cal.App.4th 1251, 1262-1263, 117 Cal.Rptr.2d 875 (2002). It is often an open question whether the parties would have entered into a subsequent agreement, let alone what the

contents of that agreement would have been. *Venture Assocs.*, 96 F.3d at 281 (Cudahy, J., concurring).

[¶50] The primary argument for expectation damages appears to be that they are necessary to prevent bad faith. *Venture Assocs.*, 96 F.3d at 278-280. “Bad faith is deliberate misconduct.” *Id.* at 279. Permitting expectation damages is seen as an effective tool to prevent one party from trying to ruin another or extorting additional concessions from the other party. *Id.* at 278. Other judges have focused on the fact that consequential damages normally would flow from breach of a completed contract, so they ought to apply in this arena as well. *Logan v. D.W. Sivers Co.*, 343 Or. 339, 169 P.3d 1255, 1266-1267 (2007) (Kistler, J., concurring in part and dissenting in part).

[¶51] It is unclear why reliance damages are necessarily insufficient to make a party whole when there has been a breach of a contract to further negotiate. There also are other reasons why this is an inappropriate policy for this state. Washington law already prohibits speculative damages for breach of contract. *Larsen v. Walton Plywood Co.*, 65 Wash.2d 1, 16, 390 P.2d 677 (1964). Contracts to further negotiate that are as nebulous as this one require significant speculation about what terms would have been agreed upon and provide little basis beyond speculation for assessing damages for breach. * * * *

[¶52] * * * * As a matter of policy, I think it is undesirable to force agreement on parties under threat of a bad faith finding and subsequent imposition of consequential damages, the same sanction as would issue from actual agreement. Freedom not to contract should be protected as stringently as freedom to contract. The present case is an excellent example of how preliminary negotiations may be pyramided into a demand indistinguishable from a claim for breach of contract.

Reliance damages should be an adequate sanction for breach of an agreement to negotiate in good faith. Presumably, punitive damages could be assessed in egregious cases. With those sanctions, a good faith obligation is more likely to be enforced than if the matter could be escalated into what appears to be a breach of contract suit. [*Venture Associates Corp. v. Zenith Data Systems Corp.*, 96 F.3d 275, 281 (7th Cir.1996) (Cudahy, J., concurring).]

[¶53] Given existing Washington law and the mixed incentives created by the expectation damages, I would hold that breach of a contract to negotiate involving a new business venture should result only in reliance damages. In this case, I would remand for a trial solely on damages. * * * *

Measure of Damages

[¶54] While I conclude that expectation damages are not appropriate, a brief comment on the factual basis for the damages awarded in this case is still in order. Columbia calculated

the value of its development interest by reducing the expected “revenue stream” to a present value figure.

[¶55] Methinks the Bard correctly identified the problem at issue here: “What's in a name? That which we call a rose by any other word would smell as sweet.” William Shakespeare, *Romeo and Juliet* act 2, sc. 2. Capitalizing projected profits and recasting them as the market value of the development opportunity is simply calling lost profits by another name.

[¶56] If a claim of lost profits for a new business venture is too speculative to permit a jury to consider the issue, the same rule should apply to a business owner speculating that someone would buy his speculative profits. That should particularly be the case where the profits are based on an agreement of unknown terms. If there was a market for this DOA, potential investors could have been called to testify to that fact and its value to them. The evidence presented here was just Columbia claiming lost profits under another guise.

Questions:

1. In [¶40], the court says that whether a loss is proved with "sufficient certainty is . . . generally a question of fact." Why only generally? Why not always?
2. The second footnote in [¶44] contains a fundamental factual error. What did Columbia discount to present value? What did Tri-River report? Can you see the problem?
3. In a portion of the opinion not listed here, Judge Siddoway claims that the majority of courts across the country would limit damages to reliance in cases such as this. Would reliance damages make Columbia whole?
4. Do you agree with Judge Siddoway that the point of imposing expectation damages is to prevent bad faith? If so, is the “bad faith” that Siddoway is talking about the same kind of bad faith we saw earlier when we studied the duty to cooperate? Or does Siddoway mean something else? Why is the majority intent on imposing an expectation measure on the City?
5. Was Columbia’s evidence of expectation damages speculative? Judge Siddoway implies that no potential buyers were called as witnesses. Is that relevant?
6. What fact in the case suggests that the evidence Columbia presented of the value of its development rights should not be opposed by the City on the ground that it was speculative?
7. What kind of evidence would show non-speculative lost profits in a new business?

8. In *Hall v. Nassau Consumers' Ice Co., Inc.*, 183 N.E. 903 (N.Y. 1933), the plaintiff was a purchaser of seven debentures of gold bonds issued by Nassau Consumers in 1925. The bonds were payable May 1, 1940 unless sooner called for payment. The company was to pay interest of 8% each year until the bonds were redeemed. But each bond also contained the following clause: "On the 1st day of May, in each of the years 1930 to 1939, inclusive, there shall be called for payment by lot under procedure to be determined by the Board of directors of the Nassau Consumers Ice Co., Inc., the sum of Five Thousand (\$5,000) Dollars. This bond may be called for redemption at 105 per cent of its face value and accrued interest." The plaintiff alleged in the suit that none of the bonds were called for payment in 1930 or 1931. Would damages for failing to call a bond by lot be speculative?

Suppose I enter a beauty contest with a \$10,000 prize and the entity conducting the contest breaches its contract by conducting it on terms different in a material way from those promised—say, by rigging the competition so that Miss Texas City wins for sure and I am given no chance. Let's suppose there are 10 contestants total, and Miss Texas City had no idea that the contest was rigged and did not contribute to the breach. What are my damages?

2. Foreseeability

HADLEY v. BAXENDALE 9 Exchequer 341 (1854), 156 ER 145

[¶1] 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 11th 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 12th, and on the 13th 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 2l. 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 25l. 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.

[¶4] Keating and Dowdeswell (Feb. 1) shewed cause. The plaintiffs are entitled to the amount awarded by the jury as damages. These damages are not too remote, for they are not only the natural and necessary consequence of the defendants' default, but they are the only loss which the plaintiffs have actually sustained. * * * *

[¶5] Whateley, Willes, and Phipson, in support of the rule. It has been contended, on the part of the plaintiffs, that the damages found by the jury are a matter fit for their consideration; but still the question remains, in what way ought the jury to have been directed? It has been also urged, that, in awarding damages, the law gives compensation to the injured individual. But it is clear that complete compensation is not to be awarded; for instance, the non-payment of a bill of exchange might lead to the utter ruin of the holder, and yet such damage could not be considered as necessarily resulting from the breach of contract, so as to entitle the party aggrieved to recover in respect of it. * * * * The damages here are too remote. * * * * The rule, therefore, that the immediate cause is to be regarded in considering the loss, is applicable here. There was no special contract between these parties. A carrier has a certain duty cast upon him by law, and that duty is not to be enlarged to an indefinite extent in the absence of a special contract, or of fraud or malice. * * * * Here the declaration is founded upon the defendants' duty as common carriers, and indeed there is no pretence for saying that they entered into a special contract to bear all the consequences of the non-delivery of the article in question. They were merely bound to carry it safely, and to deliver it within a reasonable time. The duty of the clerk, who was in attendance at the defendants' office, was to enter the article, and to take the amount of the carriage; but a mere notice to him, such as was here given, could not make the defendants, as carriers, liable as upon a special contract. * * * * This therefore is a question of law, and the jury ought to have been told that these damages were too remote; and that, in the absence of the proof of any other damage, the plaintiffs were entitled to nominal damages only: *Tindall v. Bell* (11 M. & W. 232). * * * * If the defendants should be held responsible for the damages awarded by the jury, they would be in a better position if they confined their business to the conveyance of gold. They cannot be responsible for results which, at the time the goods are delivered for carriage, are beyond all human foresight. * * * * Where the contracting party is shewn to be acquainted with all the consequences that must of necessity follow from a breach on his part of the contract, it may be reasonable to say that he takes the risk of such consequences. * * * *

The judgment of the Court was now delivered by

[¶6] ALDERSON, B. 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. * * * *

[¶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 to 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 cognisant 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 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 that mill. 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 a 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—each 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.

Questions:

1. Is this rule default or mandatory?
2. Is FedEx liable for consequential?
3. Mitigation

ZAYRE CORP. v. CREECH
Fla. App. (1986), 497 So.2d 706

DOWNEY, J.

[¶1] Zayre Corporation appeals a final judgment in favor of appellee James R. Creech for breach of an employment agreement.

[¶2] It appears that Creech had been employed by Zayre for a number of years until his employment was terminated as of September 1984. He sued Zayre claiming that he had an oral contract of employment from June 1, 1984 to May 31, 1985 and that his termination without cause was a breach of said contract. The trial court ruled in Creech's favor finding that Zayre had paid Creech for forty-four weeks by including vacation and severance pay and that Zayre owed him for several weeks' salary plus a bonus of \$7,338.

[¶3] Zayre contends on appeal that within ten weeks after he was terminated Creech was employed by Richway at an annual salary of \$34,000. As a result, Zayre argues that

Creech's damages were completely mitigated because his earnings for the annual period in question exceeded the salary due him under his contract with Zayre. The trial judge rejected this defense and made no deduction for the earnings recovered by Creech during the remainder of the term in question. That ruling is erroneous because the established rule in Florida in employment situations of this kind is set forth in *Juvenile Diabetes Research Foundation v. Rievman*, 370 So.2d 33, 35-36 (Fla.3d DCA 1979), as follows:

The law is clear that the purpose of an award of damages in a breach of contract action is to place the injured party in the same financial position as he would have occupied if the contract has been fully performed. *Hodges v. A.P. Fries & Co.*, 34 Fla. 63, 69, 15 So. 682, 684 (1894); *Popwell v. Abel*, 226 So.2d 418, 422 (Fla. 4th DCA 1969); *First National Insurance Agency, Inc. v. Leesburg Transfer & Storage, Inc.*, 139 So.2d 476, 482 (Fla. 2d DCA 1962). It is, therefore, the established law of this state that in an action for breach of an employment contract [brought by an employee for an alleged wrongful discharge prior to completion of the contract] the prima facie measure of damages is the contract price of salary or wages for the unexpired term of the contract together with any unpaid balance due under the contract for services rendered before the wrongful discharge. *Hazen v. Cobb*, 96 Fla. 151, 117 So. 853 (1928); 2 Fla.Jur.2d "Agency and Employment" § 134, p. 315 (1977)

These prima facie damages, however, are subject to reduction upon proof of an amount which the employee actually earned, or could have earned through the use of due diligence in other employment of like nature, for the remainder of his term of employment under the contract. *Southern Keswick, Inc. v. Whetherholt*, 293 So.2d 109 (Fla. 2d DCA 1974). In this connection, it is often said that the plaintiff employee has a duty to mitigate his damages by reasonably seeking other employment of like nature subsequent to the breach of contract; the penalty for failing to comply with that duty is a reduction in his recoverable damages in the amount he could have earned had he complied with such duty.

Accordingly, Creech was not entitled to recover the balance of his salary or bonus for the 1984-85 year because the amount he earned after his wrongful discharge exceeded the balance due him from Zayre for salary and bonus.

[¶4] Nevertheless, the general rule in cases of this type is that the measure of damages recoverable for breach of a contract of employment for a definite term is the amount of compensation agreed upon for the remainder of the period involved, less the amount which the servant earned, or with reasonable diligence might have earned, from other employment during that period. However, if following the discharge, the former employee has earned more than the price agreed to be paid, his recovery is limited to nominal damages only. 53 Am.Jur.2d Master and Servant § 62 (1970). E.g. *Board of Education of Alamogordo Public School District No. 1*, 102 N.M. 762, 701 P.2d 361 (1985). This rule is also followed in Florida where a contract has been breached but for one reason or another recoverable

damages were not proven. See *AMC/Jeep of Vero Beach, Inc. v. Funston*, 403 So.2d 602 (Fla. 4th DCA 1981); *Muroff v. Dill*, 386 So.2d 1281 (Fla. 4th DCA 1980).

[¶5] In view of the foregoing, the provisions of the judgment awarding Creech \$13,378 are reversed and the cause is remanded to the trial court with directions to enter a judgment for Creech for nominal damages only.

Questions:

1. Would it be possible for a fired employee to win on the mitigation issue even though the employee did nothing to find another job? Would it be possible for the fired employee to have no reduction for mitigation even though the employee immediately started working in another job and continued in that job until the end of the term? Reading the rule very carefully should show you the answers to these questions.

2. In one well-known case, *Parker v. Twentieth Century-Fox Film Corp.*, 89 Cal. Rptr. 737 (Cal. 1970), Shirley MacLaine Parker signed a contract with Twentieth Century-Fox ("TCF") to star in TCF's production of the movie-musical "Bloomer Girl." The contract was to last from May 23, 1966, for fourteen weeks and pay \$53,571.42. The film was to be made in California, and under the contract Ms. Parker had approval rights for the director, dance director, and screenplay. Prior to May 1966, TCF notified Ms. Parker that it had decided not to make the movie and would not pay her. The letter notifying Parker offered her the starring role in another film called "Big Country, Big Man," a western to be filmed in Australia, for the same compensation. The attached, proffered contract for "Big Country, Big Man," unlike the contract for the first movie, gave TCF the option to decline to make the movie and pay Ms. Parker her compensation instead. And, in this second contract Ms. Parker had no rights to approve anyone or the screenplay, but TCF promised to consult with her as to those things. Ms. Parker declined to sign the second contract. Instead, she sued for breach. TCF argued that Parker had, by failing to sign onto the "Big Country, Big Man" project, failed to mitigate. What result should the court reach? Consider also the following:

- a. Suppose TCF sold its rights in the Bloomer Girl project to Paramount, which then offered to employ Parker in the same role under the exact same terms except that Parker's pay would be 25% less. Would TCF then owe her 75% less in damages?
- b. TCF's lawyer may have made an error in TCF's argument about mitigation by limiting it to the "Big Country" project. What was the error?
- c. Might the case reach the same result if Parker declined all other movies for the relevant time period, did not seek to perform in any movies then, and instead moved to the mountains of New Mexico to live a life of meditation? Even with complete mitigation, shouldn't a plaintiff such as Ms. Parker be awarded something?

PROBLEM 11: A hires B to build a house for \$100,000. B buys \$20,000 worth of materials and does \$15,000 worth of work that uses up all \$20,000 in materials. Then A fires B for

no good reason. The house would have cost B \$90,000 to build. What are B's expectation damages? Why is the amount less than \$100,000?

SEARS, ROEBUCK AND CO., INC. v. Theodore GRANT
Wash. (1956), 298 P.2d 497, 49 Wash.2d 123

HILL, J.

[¶1] In an action by Sears, Roebuck and Company, Inc. (hereinafter referred to as Sears), to recover possession of certain crop sprinkling equipment or its value, the defendant, Theodore Grant (formerly Theodore Gruzdis), made a counterclaim for damages for the loss of a forty-acre wheat crop. Grant claimed that delay in the delivery of 320 feet of two-inch aluminum pipe necessary as laterals in the operation of his sprinkling system caused the loss of the crop. The ultimate issue on this appeal is whether Grant proved damages in the amount of \$2,828 which the jury found he sustained. (The judgment was for that amount less the value of the crop sprinkler equipment retained by him, or \$1,318.18.) Sears appeals.

[¶2] By conditional sales contract dated April 6, 1953, Sears sold Grant certain crop sprinkling equipment, knowing that Grant was acquiring it to enable him to irrigate a forty-acre tract on which he had planted wheat the preceding fall. The equipment purchased included an electric pump, 1,240 feet of aluminum pipe (460 feet of four-inch, 460 feet of three-inch, and 320 feet of two-inch), nineteen standpipes and sprinkler heads, and various other fittings and connections.

[¶3] Sears agreed to make immediate delivery, and all of the equipment covered by the contract was delivered to Grant at Moses Lake on April 14th and 23rd except the two-inch pipe, which was not delivered until May 25th or 26th.

[¶4] Grant's major contention is that, if the two-inch pipe had been delivered by May 1st or shortly thereafter, he could have irrigated the forty-acre tract and harvested sixty bushels of wheat to the acre, whereas he harvested a total of only 115 bushels from twenty acres. The other twenty acres he plowed under sometime between May 5th and May 20th, and replanted in beans in an effort to mitigate his damages.

[¶5] No exceptions were taken to any of the instructions given by the trial court, and the measure of damages applicable to such a breach of contract is not in dispute. It is argued, however, that Grant did not prove with reasonable certainty the amount of wheat he would have raised, and that he could have and should have further mitigated his damages.

[¶6] The only evidence as to what the yield would have been if the respondent had been able to put water on the land at the proper time was his estimate that the acreage in wheat nearest his, a tract one-half mile away, produced "roughly" sixty bushels to the acre. That tract, farmed by Marvin Anderson, was newly reclaimed from sagebrush and had never

been planted before. The bureau of reclamation rated the soil lower than that on respondent's tract. Anderson's preparation for planting was very similar to respondent's on that portion of the latter's land that was being planted for the first time. The Anderson tract was irrigated by a sprinkler system, commencing about May 1st, which is the date respondent claims he should have been able to begin to put water on his wheat.

[¶7] Appellant assigns error to the admission of this evidence, both because of the lack of qualification on the part of respondent to make an estimate as to the yield from the Anderson tract and because conditions on the two tracts were not shown to be sufficiently similar to make the testimony relevant.

[¶8] Respondent had raised wheat, though on a very limited scale, for the six preceding years, and the trial court ruled that he was qualified to testify and that all of appellant's objections went to the weight rather than the admissibility of his testimony. We agree. *Chung v. Louie Fong Co.* (1924), 130 Wash. 154, 226 Pac. 726; *Smith v. Hicks* (1908), 14 N.M. 560, 98 Pac. 138, 19 L.R.A. (N.S.) 938.

[¶9] From this testimony, there was a permissible inference that respondent's yield from his land would have been similar to Anderson's if the land had been irrigated at the proper time. Appellant offered no evidence either to establish that the respondent's estimate as to the yield from the Anderson land was high or to show wherein conditions differed materially between the two tracts.

[¶10] Appellant urged that the respondent could have further mitigated his damages, if any, and suggested two methods: first, renting or buying two-inch pipe from a dealer other than the appellant, or buying three-inch pipe from the appellant and paying the difference in value between the three-inch and the two-inch pipe; second, revamping his plans and utilizing the three and four-inch pipe to irrigate a lesser area and thus save at least a portion of his crop.

[¶11] Whether a reasonable man would have resorted to either of these methods to mitigate his damages under the same circumstances, was certainly a matter to be considered by the jury. Respondent testified that every time he "talked to a person or called them on the phone" he was assured that the two-inch pipe "was either on its way or in transit and would be there any day." The jury apparently found, as it was permitted to do under the instructions, that such assurances were given, that the respondent had a right to rely on them, and that they justified his failure to mitigate damages in the ways suggested. *Lopeman v. Gee* (1952), 40 Wn. (2d) 586, 245 P. (2d) 183, 32 A.L.R. (2d) 904; *Florence Fish Co. v. Everett Packing Co.* (1920), 111 Wash. 1, 188 Pac. 792.

[¶12] The jury was entitled to find, under the court's instructions, that the appellant had promised and not made immediate delivery of the two-inch aluminum pipe, and, on the basis of the testimony of appellant's witness, that appellant could easily have procured the

necessary two-inch pipe or substituted three-inch pipe and thus fulfilled its contractual obligation.

[¶13] The jury was entitled to find that the moisture went out of the ground about May 1st; that, because the two-inch pipe had not been delivered, the respondent was unable to irrigate at that time and during the period which immediately followed; and that this caused the failure of his wheat crop.

[¶14] Most of the judges who have considered this appeal are impressed with appellant's argument on the issue of damages. They regard this as a weak and borderline case but are nonetheless satisfied that there is more than a scintilla of evidence to sustain the jury's verdict. Appellant has, we believe, underestimated the strength of respondent's evidence to establish damage and the cause thereof in the absence of any direct attack upon it and, we are certain, has overestimated the extent of our judicial knowledge about the yield of wheat to be expected under certain conditions. Appellant earnestly and vigorously insists that to anyone familiar with wheat farming it would be obvious that "it would be a miracle" if respondent "got his seed back" in 1953 under the existing circumstances, entirely apart from the availability of irrigation. Appellant offered no evidence to support that statement, and we are compelled to disclaim any such familiarity with wheat farming.

[¶15] We agree with the trial judge that the respondent made a case for the jury on the issues of breach of contract, the amount of damage sustained, and the reasonableness of his actions relative to mitigation of damage.

Judgment affirmed.

Questions:

1. What kind of damages did Grant seek: expectation, reliance, or restitution?
2. Why regard this as a "weak and borderline case"?
3. What is the rhetorical effect of all the judicial modesty in [¶14]? Was that its purpose?

4. Punitive Damages

WERNER, ZAROFF, SLOTNICK, STERN & ASKENAZY v. Donald R. LEWIS
Civ. Ct., N.Y. Cty. (1992), 588 N.Y.S.2d 960

BRAUN, J.

[¶1] This is an action for, inter alia, breach of contract, in which this court held a nonjury trial over the course of eight days. Plaintiff is a law firm which has a subspecialty of assisting its clients to collect claims under the No-Fault Insurance Law. Defendant is a computer consultant. Plaintiff was having some difficulties with its computer so it contracted with defendant to remedy the problems. Defendant did so, and plaintiff paid him for his services. Defendant then convinced plaintiff to upgrade its computer system. Plaintiff orally agreed to retain defendant for that purpose. With defendant's assistance, plaintiff purchased a new computer, and defendant modified plaintiff's software to make it compatible with the new computer.

[¶2] Defendant estimated that the cost to plaintiff on this second contract would be \$4,000-\$5,000. The work took much longer than had been anticipated, and plaintiff ended up paying defendant a total of \$21,375 on the second contract. On January 18, 1986, plaintiff made its last payment to defendant on the second contract. The payment was made at plaintiff's office. Defendant then put a floppy disk into plaintiff's computer, and said to one of plaintiff's partners that, if plaintiff had not paid defendant, he would not have entered the data contained on the floppy disk into the computer, which would have subsequently crashed.

[¶3] After that date, once per month defendant telephoned the person employed by plaintiff who did the computer data entry work for plaintiff, and asked her how the computer was performing and what claim number plaintiff had reached. Plaintiff's computer contained a software program modified by defendant, which included data on plaintiff's no-fault insurance clients. Each claim of those clients was assigned a claim number.

[¶4] That computer program in plaintiff's system shut down at claim number 56789 in July 1986. After that number, the system could not be utilized in the directory existing for the program, which significantly interfered with plaintiff's ability to work on its clients' claims and do billing. Although plaintiff's program could have functioned again if a new subdirectory was created each time that it stopped working at 56789, plaintiff was not aware that such a solution to the problem was possible. The cause of the problem was that defendant intentionally placed in the program a conditional statement, of which plaintiff had been unaware. The conditional statement was a hidden directive in the program which caused the program to stop working when it reached claim number 56789. Although

defendant denied doing so, the court does not credit his testimony, in part because number 56789 is an inherently suspicious number at which the program stopped functioning.

[¶5] The subject program in plaintiff's computer was in executable form only. This means that, although the program was used on the computer screen in English and numbers, its structure was entered in the computer only in computer language. Thus, in order to modify the structure of the program, one had to have the source code for the program. Defendant had kept the source code. Defendant told one of plaintiff's partners that he had destroyed the source code and that it would have had to be redone to modify the program.

[¶6] Defendant gave no warranties to plaintiff. Defendant solicited a maintenance contract from plaintiff to cover any problems that might arise with plaintiff's system after defendant had completed his work, but plaintiff declined the offer because its partners thought that it had already paid defendant too much money for his services.

[¶7] After the computer program shut down, plaintiff hired another computer consultant to work on the computer system, so that the program could function again. He was successful, and plaintiff paid him \$7,000 for his services. That consultant testified credibly that it was his opinion that the computer program had crashed due to a conditional statement that defendant had secretly placed in the program.

[¶8] Defendant's computer consulting business had slowed to a trickle at the time that he completed his work for plaintiff. It is this court's conclusion that defendant intentionally put the conditional statement into plaintiff's software, with the hope that, after the system stopped, plaintiff would retain him again to correct the problem.

[¶9] Defendant breached his second contract with plaintiff, although he did provide some services to plaintiff thereunder. Plaintiff is entitled to compensatory damages from defendant in the amount of \$7,000 in order to reimburse plaintiff for its cost of hiring the second computer consultant to cure the problems created by defendant with plaintiff's computer program.

[¶10] In one of its causes of action, plaintiff seeks only punitive damages against defendant. Punitive damages are not a separate cause of action. (*APS Food Sys. v Ward Foods*, 70 A.D.2d 483, 488 [1st Dept 1979]; *Levine v Constanzo*, NYLJ, Nov. 1, 1991, at 21, col 4 [App Term, 1st Dept].) However, punitive damages need not be specifically requested in a complaint. (*Gill v Montgomery Ward & Co.*, 284 App Div 36, 40 [3d Dept 1954]; *Korber v Dime Sav. Bank*, 134 App Div 149, 150 [2d Dept 1909]; *Sanders v Rolnick*, 188 Misc. 627, 631 [App Term, 1st Dept], *affd without opn* 272 App Div 803 [1st Dept 1947].) In order to justify an imposition of punitive damages, a complaint must allege the elements of malice, willfulness, wantonness or recklessness, or at least facts supporting the imposition of punitive damages. (See, *Fittipaldi v Legassie*, 18 A.D.2d 331, 337 [4th Dept 1963]; *Gill v Montgomery Ward & Co.*, *supra*, 284 App Div, at 40; *Bingham v Gaynor*, 135 App Div 426, 427 [1st Dept 1909]; *Kipsborough Realty Corp. v Goldbetter*,

81 Misc.2d 1054 [Civ Ct, NY County 1975]; *Dembar v Reynolds & Co.*, 40 Misc.2d 84 [Sup Ct, NY County 1963].)

[¶11] Although the general rule is that punitive damages are not awarded for breach of contract claims, they "may be awarded when to do so would 'deter morally culpable conduct.' (*Halpin v Prudential Ins. Co.*, 48 N.Y.2d 906, 907; *Williamson, Pickett, Gross v Hirschfeld*, 92 A.D.2d 289, 295 [punitive damages for conduct involving bad faith].)" (*Minjak Co. v Randolph*, 140 A.D.2d 245, 249 [1st Dept 1988]; see, *Hubbell v Trans World Life Ins. Co.*, 50 N.Y.2d 899, 901 [1980]; *Mandelblatt v Devon Stores*, 132 A.D.2d 162, 167 [1st Dept 1987].) "It is not the form of the action that gives the right * * * to give punitive damages, but the moral culpability of the defendant." (*Hamilton v Third Ave. R. R. Co.*, 53 N.Y. 25, 30 [1873].) As the Court of Appeals stated in the lead case of *Walker v Sheldon* (10 N.Y.2d 401, 404 [1961]):

"Punitive or exemplary damages have been allowed in cases where the wrong complained of is morally culpable, or is actuated by evil and reprehensible motives, not only to punish the defendant but to deter him, as well as others who might otherwise be so prompted, from indulging in similar conduct in the future. (See, e.g., *Tommey v. Farley*, 2 N.Y.2d 71, 83; *Krug v. Pitass*, 162 N.Y. 154, 161; *Hamilton v. Third Ave. R. R. Co.*, 53 N.Y. 25, 28; *Oehlhof v. Solomon*, 73 App. Div. 329, 333-334.) * * * Moreover, the possibility of an award of such damages may not infrequently induce the victim, otherwise unwilling to proceed because of the attendant trouble and expense, to take action against the wrongdoer."

[¶12] Plaintiff did plead in its breach of contract cause of action under which compensatory damages are being awarded that defendant's conduct was done "with malicious intent". This is a sufficient pleading to entitle plaintiff to punitive damages, and defendant's actions here call out for the imposition of punitive damages against him.

[¶13] Defendant's actions were arguably the commission of a class A misdemeanor. Penal Law § 156.20 provides:

"A person is guilty of computer tampering in the second degree when he uses or causes to be used a computer or computer service and having no right to do so he intentionally alters in any manner or destroys computer data or a computer program of another person."

Certainly, defendant had no right to do so when he put the conditional statement in plaintiff's program and caused it to crash. His act was clearly intentional. It would thus appear that he committed a crime when he acted as he did. (See, *People v Versaggi*, 136 Misc.2d 361 [Rochester City Ct 1987].) To the extent that defendant's actions may not fit under the Penal Law, the New York State Legislature should act in this computer age to amend the law.

[¶14] Computers are intricate machines, and their software programs are often complexly designed, and written in mathematical language. Most people who use computers do not have the expertise to remedy problems that arise with computers and computer software.

Thus, members of the general public are often captives of those who have developed the expertise needed to understand computers and computer programs, and must rely upon those experts to act with good faith.

[¶15] Some people with computer expertise have utilized their advanced knowledge to instill great anxiety in the computer-using business and consumer public, and have caused great damage to some of them. Only a few months ago, the users of computers nationwide, including those in the courts of Manhattan, were plagued by fears that computer viruses had been planted in their computer programs which would have caused, and in some cases did cause, their computers to crash. (See, NY Times, Mar. 7, 1992, at 1, col 5; at 6, col 2 [Natl ed]; Pines, Federal, State Courts Attack Computer Virus and Prevail — So Far, NYLJ, Mar. 4, 1992, at 1, col 3.) Although the culprits there may not have been caught, defendant has been, and the imposition of punitive damages against defendant should send a message to others who would consider committing similar acts in the future, and even to some who may eradicate their already planted, as yet silent viruses which are presently waiting to awaken and wreak their havoc.

[¶16] This court regrets that it is confined by the complaint before it to be able to only award punitive damages of \$18,000 against defendant, that being the total of \$25,000 sought in the subject cause of action minus the \$7,000 already awarded as compensatory damages. Defendant's actions in breaching his contract with plaintiff were morally culpable and seemingly criminal. Therefore, this court finds for plaintiff against defendant in the amount of \$7,000 compensatory damages and \$18,000 punitive damages.

Questions:

1. Is extortion a tort?
2. Why not allow punitive damages for breach of contract? Is it because the moral prohibition against breach of contract extends only to the point of satisfying the non-breaching party's expectations? We don't believe that breach is in and of itself wrong? Or perhaps we do not believe, for some other reason, that the state should be punishing it?
3. Would awarding punitive damages for breach of contract force parties to act inefficiently? If a seller can breach a contract with a buyer, compensate the buyer for its loss, and still come out ahead, shouldn't the seller do so? In such a case, the seller is better off, the buyer is no worse off, and the products that the seller is selling end up in the hands of the person who values them most.
4. What purposes do punitive damages serve? Are those purposes served well here?
5. Another exception to the general rule has arisen in cases in which an insurance company refuses to pay for a loss clearly covered under a policy. The California Supreme Court led the way in imposing on such insurers a tort of "bad faith breach" of an insurance contract,

often found when the insurer had rejected a reasonable settlement offer. *See, e.g., Neal v. Farmers Ins. Exch.*, 148 Cal. Rptr. 389 (Cal. 1978). Punitive damages were available. Many states followed California's lead. Some suggested that courts should go further, offering punitive damages for all breaches in bad faith, and California arguably did so, for a time, but the California and other courts have now mostly stopped the growth of this "tort" and firmly restricted it to the insurance area. Is the idea of punishing "bad faith breach" a good one?

5. Liquidated Damages

BOWBELLS PUBLIC SCHOOL DISTRICT NO. 14 v. Marcia WALKER North Dakota (1975), 231 N.W.2d 173

PAULSON, J.

[¶1] This is an appeal from a judgment in which we are to determine the validity of a contract clause providing for the payment of a fixed amount of damages by Marcia Walker, a married teacher, who breached her employment contract with Bowbells Public School District No. 14.

[¶2] The Grand Forks District Court found that Mrs. Walker breached her employment contract with the Bowbells Public School District No. The court also found that the employment contract contained a valid liquidated-damages provision, and, on that basis, ordered Mrs. Walker to pay to the school district the sum stipulated in the contract as damages. On December 16, 1974, judgment was entered for the school district in the amount of \$252, plus costs and disbursements. It is from this judgment that Mrs. Walker appeals.

[¶3] The parties to this action have stipulated to the following facts:

"a. The defendant [Marcia Walker] was an employee of the plaintiff [school district] during the 1972-1973 school year which began in September of 1972.

"b. In September of 1972 the defendant joined the Bowbells Education Association, the North Dakota Education Association and the National Education Association by paying her yearly dues.

"c. In order to negotiate contract terms for the 1973-1974 school year the plaintiff and the Bowbells Education Association each chose negotiating committees to represent them at the contract negotiation meetings. These meetings began early in 1973.

"d. The negotiation committee of the Bowbells Education Association was given the power by the association members to make binding agreements with the plaintiff.

"e. During their January 10, 1973 meeting the negotiation committees agreed that a release from a signed contract could be granted until May 15 at no expense to the teacher; 1% of the contracted amount [after May 15; 2%] after June 15; 3% after July 15; and 4% after August 15.

"f. The defendant signed a contract to teach for the plaintiff during the 1973-1974 school year. The contract is dated March 23, 1973.

"g. The defendant contracted to teach for 180 days beginning on September 1, 1973. She was to receive \$6300.

"h. On August 19, 1973, the defendant asked the Superintendent of the Bowbells School District to be released from her March 23, 1973 contract as her husband was moving from the area and she wanted to go with him.

"i. In a letter to the plaintiff dated August 26, 1973 the defendant stated she would not be able to remain at Bowbells and asked for her release.

"j. On August 30, 1973, after finding a replacement, the plaintiff released the defendant from her contract and requested that she pay the damages in accordance with the agreement between the plaintiff and the Bowbells Education Association. The defendant has not paid."

[¶4] The principal question is whether the fixed-damages provision of the contract, as outlined in paragraph "e" of the stipulated facts, constitutes a valid liquidated-damages clause or whether it is void, as constituting a penalty, under § 9-08-04, N.D.C.C., which provides:

"Fixing damages for breach void--Exception.--Every contract by which the amount of damages to be paid, or other compensation to be made, for a breach of an obligation is determined in anticipation thereof is to that extent void, except that the parties may agree therein upon an amount presumed to be the damage sustained by a breach in cases where it would be impracticable or extremely difficult to fix the actual damage."

It is Mrs. Walker's contention that the contract clause in question comes within the proscription of § 908-04, N.D.C.C., and is, therefore, void. The school district maintains that the damages occasioned by Mrs. Walker's breach of contract are extremely difficult to ascertain and, thus, the clause in question is valid as an exception to the statutory prohibition. We hold that the contract clause providing for fixed damages is valid and we affirm the decision of the district court.

[¶5] Pursuant to § 9-08-04, N.D.C.C., our primary consideration is whether the damages stemming from a particular breach of contract are 'impracticable' or 'extremely difficult' to ascertain--a prerequisite to the use of a fixed-damage provision. The determination of this issue necessarily depends upon the facts of each particular case and in making this determination, we must look at the facts of each case as they appeared to the parties at the time the contract was made. *Hofer v. W. M. Scott Livestock Company*, 201 N.W.2d 410 (N.D. 1972).

[¶6] We recognize, initially, that in cases where an employee has breached an employment contract, the damages generally recoverable and, thus, properly anticipated, are limited to the costs of replacing the employee. We are not unmindful of the fact that this is a public contract and that it is the public as a whole that suffers when such a contract is breached. In this respect, this case is not unlike those cases in which a governmental body liquidates the amount of damages it may recover for a delay in the performance of a public construction contract. Although the damages suffered by the governmental body itself may be readily ascertainable, the damages sustained by the public are not readily ascertainable, and, on such basis, liquidated-damages provisions are generally upheld, even in States having statutes similar to § 9-08-04, N.D.C.C. See, e.g., *Dave Gustafson & Co. v. State*, 156 N.W.2d 185 (S.D. 1968); *Six Companies of California v. Joint Highway Dist. No. 13 of California*, 110 F.2d 620 (9th Cir. 1940), rev'd on other grounds in 311 U.S. 180, 61 S.Ct. 186, 85 L.Ed. 114.

[¶7] The courts have recognized that the actual loss is suffered by the public for whose benefit such contracts are made and that because of the extreme difficulty in ascertaining this public loss, liquidated-damages provisions in those cases are properly enforced.

[¶8] Although we have not previously decided this issue, we indicated in *Hofer*, supra 201 N.W.2d at 416, that:

"There may be circumstances involved in public contracts and other laws relating to public contracts that justify a more liberal treatment of forfeiture clauses in public contract cases."

These words from *Hofer* indicate an awareness of the issue with which we are presently confronted. Thus, when we consider the damages caused by a teacher's breach of an employment contract, we cannot ignore the interruption to the school system and the resultant debilitating effect such interruption has upon the learning process of students in the school system. The possibility that the replacement teacher who was obtained may be less experienced or less qualified and, thus, a less effective instructor must also be considered in the assessment of damages. It would not be possible at the time of contracting to foresee all these elements of damage that may occur. Even if known, it would be extremely difficult to evaluate these damages on a monetary basis. These losses to the public are no less the proper subject of a liquidated-damage provision than are the losses sustained by the public in delay-of-performance situations. In either case, the damage to the public is real, although most difficult to evaluate. Such damages are not legally compensable but constitute a public injury which the school district was entitled to consider. For these reasons we find that the present case falls within the exception of § 9-08-04, N.D.C.C.

[¶9] A contract provision, to be upheld as a valid liquidated damages clause, must not only meet the statutory requirement of § 9-08-04, N.D.C.C., but also must fulfill the

requirements imposed by case law. In *Hofer*, supra, in paragraph 2 of the syllabus, we delineated these requirements:

"Under South Dakota law a provision for payment of a stipulated sum as a liquidation of damages will be sustained if it appears that at the time the contract was made the damages in the event of a breach will be incapable or very difficult of accurate estimation, that there was a reasonable endeavor by the parties to fix their compensation, and that the amount stipulated bears a reasonable relation to the probable damages and is not disproportionate to any damages reasonably to be anticipated."

Although in *Hofer* we were construing South Dakota law, the South Dakota statutes are similar to § 9-08-04, N.D.C.C. We find the rationale of that case in accord with § 9-08-04, N.D.C.C., and, accordingly, adopt *Hofer* as a proper construction of such section.

[¶10] *Hofer* requires, in addition to the statutory requisite, that there be a reasonable endeavor by the parties to fix their compensation and that the amount stipulated bears a reasonable relationship, and is not disproportionate to, any anticipated damages.

[¶11] It is argued by Mrs. Walker that there was no endeavor to fix compensation in this case, as evidenced by the fact that the same liquidated-damages provision was used in all teacher employment contracts, regardless of differences in individual characteristics of the teachers. We do not find that the inclusion of a standard liquidated-damages clause in more than one contract is necessarily incompatible with a reasonable endeavor to pre-determine compensatory damages. The law requires only that the purpose of the clause be primarily to pre-determine damages, as opposed to imposing a penalty for breach. In this regard, it is to be noted that the liquidated-damages provision under consideration is graduated, i.e., it provides for progressively larger payments for breach of the contract as the time for commencing the school term approaches. We recognized in *Hofer* that this factor indicates a bona fide attempt to pre-determine damages. It is reasonable to estimate that it will be more difficult and more costly to replace a teacher who breaches a contract during the school term or shortly before it commences than to replace one who breaches shortly after the contract is signed. The fact that this provision is contained in more than one employment contract does not render it any less an endeavor to fix damages. Furthermore, the argument that the provision in question was intended as an insurance of performance is weakened when one considers § 15-47-28, N.D.C.C., which provides:

"Suspension of teacher's certificate for breach of contract.--In the event of breach of contract on the part of a teacher, the superintendent of public instruction shall suspend such teacher's certificate for a period not to exceed one year, during which time it shall be unlawful for such teacher to receive payment for teaching in the public schools of North Dakota."

It may be seen that § 15-47-28, N.D.C.C., imposes a severe penalty upon a teacher for breach of contract. In light of the provisions of § 15-47-28, it is not persuasive to argue that the school district intended to insure performance by the imposition of what would be a much lesser penalty.

[¶12] The second requirement of Hofer is that the amount of stipulated damages must bear a reasonable relationship to the damages that may be expected to result from a breach. In the instant case the amount of damages was fixed at 4 percent of Mrs. Walker's salary, or \$252. When one considers the damages that may be caused by a breach, the dollar amount in this case is reasonable. Although we do not wish to imply that this factor is to be determined with mathematical preciseness, we do note that the percentage in this case is much smaller than the 14 1/2 percent rate that was declared void in Hofer. After applying the guidelines of Hofer, and § 9-08-04 N.D.C.C., and after considering the facts of this particular case, we conclude that the contract clause in question is valid.

[¶13] We turn now to two secondary arguments urged by Mrs. Walker. The first is that the school district "released" Mrs. Walker and that there was, therefore, no breach of contract. There was no release in this case, as that word is used in its legal sense. The school district treated Mrs. Walker's actions as a breach of her teacher's contract. Her release was subject to the payment of the liquidated damages as required by her contract; thus, this argument is not persuasive. * * * *

[¶14] It is incumbent upon the parties seeking enforcement of a liquidated-damages clause to prove that the clause is valid as an exception to the general prohibition of § 9-08-04, N.D.C.C. Hofer, supra. * * * * We hold that the school district has sustained its burden of proof.

[¶15] The decision of the district court is affirmed.

Questions:

1. Did the court care, in applying the test, whether the school district actually suffered any real damages? In a case decided with *Walker, Bottineau Public School Dist. No. 1 v. Zimmer*, 231 N.W.2d 178, 179 (N.D. 1975), the court said,

Of the issues presented and argued by Mr. Zimmer, we find but one that is not covered . . . in the Bowbells case. That is Mr. Zimmer's contention that the school district may not recover the damages stipulated in the contract because it found a replacement for Mr. Zimmer at a lower salary and, thus, suffered no actual damage. *Id.* at 179. Given what the court said in *Walker*, what should be its response? But consider the next question.

2. Though the test is ostensibly aimed at conditions existing at formation, courts are not always consistent regarding the evidence they allow to show a reasonable or unreasonable relation to actual damages. The Restatement (Second) of Contracts itself comments, "If on

the other hand, proof of loss is slight, less latitude is allowed in [approximating anticipated or actual harm]. 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.” Restatement (Second) of Contracts § 356 cmt. b (1981). Should that change your answer to Question 1?

3. How can a stipulated amount be both “incapable or very difficult of accurate estimation” and also have “a reasonable relation to the probable damages”? This may make little sense in theory. What evidence did the court accept in practice that allowed it to apply the test?

4. Why is the court so concerned about liquidated damages—what is the purpose of the test? Would a liquidated damages clause requiring that damages “ten times the amount of actual damages” pass the test?

5. If the parties have freely chosen a remedy in a contract that is not unconscionable, should not the court award it? Is not unconscionability an ultimate backstop doctrine for liquidated damage provisions, too? Could the test for unconscionability substitute in for the liquidated damages test? Is there anything that would not be covered so long as we first stipulate that a contract imposing a penalty rather than damages is unconscionable? Courts often call a clause failing the test an “unconscionable penalty,” *see Garziano v. Louisiana Log Home Co.*, 569 Fed. Appx. 292, 302 (5th Cir. 2014), and a few courts have subsumed the entire liquidated damages test under unconscionability doctrine, *see Arrowhead School Dist. No. 75 Park Cty. v. Klyap*, 79 P.3d 250 (Mont. 2003) (resolving to “analyze liquidated damages clauses from the perspective of whether or not the clause is unconscionable”).

6. Agreements to Limit Damages

Joyce UNDERWOOD v. NATIONAL ALARM SERVICES, INC.
Tenn. App. (2007)

LEE, J.

OPINION

* * * *

I. Background

[¶1] This negligence case stems from a house fire which occurred at the Knoxville home of Joyce Underwood in the early morning hours of July 21, 1999. Two children died as a result of the blaze, another two were injured, and Ms. Underwood sustained a heart attack and other injuries during the incident. Before discussing the details of the fire, we will recount the legal framework that forms the basis for this lawsuit.

[¶2] Approximately five months before the fire, Ms. Underwood contracted with the defendant, National Alarm Services, Inc., d/b/a Volunteer Alarm, to install a smoke detector and provide monitoring services for the security and smoke detection system at her house, where she also operated a licensed day care facility. The system installed at Ms. Underwood's house was selected to meet state day care standards. Ms. Underwood signed an "Alarm System Monitoring and Installation Agreement" ("Agreement") with National Alarm on February 3, 1999, which provided a limitation of liability as follows:

Subscriber understands and agrees that if Company should be found liable for loss or damage due from a failure of Company to perform any of the obligations herein, including but not limited to installation, maintenance, monitoring or service or the failure of the system or equipment in any respect whatsoever, Company's liability shall be limited to Two Hundred Fifty (\$ 250) Dollars as liquidated damages/limitation of liability and not as a penalty and this liability shall be exclusive; and that the provisions of this section apply if loss or damage, irrespective of cause of origin, results directly or indirectly to persons or property from performance or non-performance of the obligations imposed by this contract, or from negligence, active or otherwise, its agents, assigns or employees.

If [S]ubscriber wishes Company to assume limited liability in lieu of the liquidated damages as herein above set forth, Subscriber may obtain from Company a limitation of liability by paying an additional monthly service charge to Company. If Subscriber elects to exercise this option, a rider shall be attached to this agreement setting forth the terms, conditions and the amount of the limited liability, and the additional monthly charge. Such rider and additional obligation shall in no way be interpreted to hold Company as an insurer.

[¶3] The fee for National Alarm's monthly monitoring service was \$ 19.95. According to an affidavit provided by the company's president, Steve Choura, Ms. Underwood paid the initial monitoring fee in February of 1999 when she signed the contract, but she did not pay any monitoring fees after that. Ms. Underwood's account was in default at the time of her house fire in July of 1999. However, neither party contends that National Alarm terminated its contract with Ms. Underwood for nonpayment, although it had the option to do so.

[¶4] On the night of the blaze, Joyce Underwood was asleep in her Knoxville residence. Staying with her that night were four young relatives, Joshua Underwood, age 10; Isaiah Underwood, age 6; 9-year-old Stefon Colquitt; and Jonesha Colquitt, age 8. According to Ms. Underwood's deposition, she was awakened by her neighbor, Robert Dixon, Jr. After she was awakened, she heard the smoke detector in her hall and the alarm system going off. Joshua Underwood also confirmed that he could hear the alarms while he was running through the house and after he got out of the house.

[¶5] Several neighbors also heard the alarms. Robin Johnson stated in her deposition that an alarm of some sort woke her up at 12:30 a.m., and she thought that it was a car alarm. Ms. Johnson said she knew the exact time because she looked at her bedside clock. She then drifted back to sleep with the alarm still ringing. Ms. Johnson said she was awakened a short time later by a "loud banging in my backyard." In her affidavit, Ms. Johnson stated that when she looked out the window, she saw her neighbor, Mr. Dixon, beating on the patio door of Ms. Underwood's home. In response to her inquiry, Mr. Dixon stated that Ms. Underwood's house was on fire and he was trying to wake her. At that time, Ms. Johnson stated that she noticed smoke coming from Ms. Underwood's home. She also said that "there were no emergency vehicles of any kind assisting despite the continual sounding of the alarm. It wasn't until some time later that the emergency vehicles arrived."

[¶6] According to Mr. Choura, National Alarm contacted 911 within 42 seconds of receiving the signal from the smoke detector system at Ms. Underwood's residence. Upon doing so, National Alarm was informed that the fire had already been reported by a neighbor and emergency units were on their way to the home. In his affidavit, Mr. Choura did not state what time National Alarm received the signal from Ms. Underwood's alarm system, nor did he specify the time that National Alarm contacted 911. Evidence provided by Ms. Underwood indicates that National Alarm did not notify 911 of the fire until 1:39 a.m.

[¶7] Although everyone in the Underwood home escaped the fire, Stefon and Jonesha Colquitt died at the hospital a few hours later as a result of smoke inhalation and carbon monoxide poisoning. Joshua and Isaiah Underwood were treated for burns, smoke inhalation, and carbon monoxide poisoning. [Joshua Underwood died on January 29, 2002, as a result of an unrelated automobile accident.] While trying to save the children, Ms. Underwood suffered a heart attack, for which she also required medical treatment.

[¶8] Gary Young, a fire investigator employed by Allstate Insurance Company, testified that the fire began due to a short in an electrical cord. The leg of a freezer had been placed on the power cord, resulting in the cord's failure. He stated that the fire in Ms. Underwood's home burned for a maximum of 30 minutes, including the time it took firefighters to extinguish the blaze. Mr. Young said that the room where the freezer was kept sustained severe fire damage, and it was the only room that showed evidence of "significant structural damage" as a result of the fire. He also stated that none of the bedrooms had fire damage, although the bedrooms did incur smoke damage.

[¶9] Ms. Underwood filed suit on behalf of herself and Joshua and Isaiah Underwood, alleging that National Alarm was negligent in virtually every aspect of its operations relating to the alarm system in her home. National Alarm filed a motion for summary judgment, which was granted by the trial court. Ms. Underwood appeals.

II. Issue

[¶10] The sole issue presented for review, as restated, is whether the trial court erred by granting summary judgment to National Alarm.

III. Standard of Review

[¶11] Summary judgment is appropriate only when the moving party demonstrates that "there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." TENN. R. CIV. P. 56.04. * * * *

IV. Analysis

[¶12] In its order granting summary judgment to National Alarm, the trial court made the following findings:

1. At the time of the fire in July, 1999, the Plaintiff Joyce Underwood had not paid fees due under the service contract. As such, no duty was owed by the Defendants. Failure by the Plaintiff to pay the fees under the contract was a substantial breach of the contract.
2. The exculpatory clauses and the clauses limiting liability are valid under Tennessee law. Those exculpatory clauses and limits of liability form a part of this contract and operate as intended to limit liability.
3. The Defendant has established through expert proof, both deposition and affidavit, that it was not negligent in the monitoring of this fire on July 21, 1999. The Plaintiff has presented no counter-veiling [sic] proof to create a material issue of fact.

We will review each of these findings separately.

A. Duty

[¶13] To establish her negligence claim, Ms. Underwood must prove: (1) a duty of care owed to her by National Alarm; (2) a breach of that duty; (3) an injury or loss; (4) causation in fact; and (5) proximate or legal cause. *Coln v. City of Savannah*, 966 S.W.2d 34, 39 (Tenn. 1998) (citing *Bradshaw v. Daniel*, 854 S.W.2d 865, 869 (Tenn. 1993)). Whether a duty of care is owed is a question of law to be decided by the trial court. *Id.*

[¶14] In order to prevail on its motion for summary judgment, National Alarm must affirmatively negate an essential element of Ms. Underwood's claim or conclusively establish an affirmative defense. Thus, if National Alarm established that it did not owe a

duty to Ms. Underwood because she failed to pay her monitoring fees for several months, then National Alarm would be entitled to judgment as a matter of law.

[¶15] National Alarm asserts that it owed no duty to Ms. Underwood because she had already breached the contract by failing to pay the monthly monitoring fee. The Agreement provided as follows regarding nonpayment:

In the event the Customer fails to make timely payments for monitoring services or files for bankruptcy protection, the Company may at it[s] sole discretion terminate monitoring services, terminate this Agreement and in such an event all payments due under this Agreement or any renewal shall be immediately due and owing by Customer to the Company.

[¶16] Thus, under the provisions of the Agreement, National Alarm could have terminated its contract with Ms. Underwood because she did not pay the \$ 19.95 per month fee. If National Alarm had terminated the Agreement, it would not owe a duty to Ms. Underwood on that basis. However, there is no evidence in the record to indicate, nor does National Alarm assert, that it exercised its right to terminate the Agreement. Therefore, National Alarm was bound by the terms of its Agreement with Ms. Underwood, and it owed Ms. Underwood a duty to perform the obligations of that contract with reasonable care. * * * *

[¶17] We find that National Alarm owed a duty to Ms. Underwood as a matter of law, and the trial court erred by finding otherwise.

B. Limitation of Liability/Liquidated Damages Clause

[¶18] Although the trial court referred to "exculpatory clauses and clauses limiting liability" in its order, the parties' contract did not contain an exculpatory clause, but rather a limitation of liability/liquidated damages clause. If this clause is valid, Ms. Underwood may only recover a maximum of \$ 250, even if she is able to prove all of the allegations enumerated in her complaint.

[¶19] In Tennessee, clauses limiting liability for negligence or breach of contract have generally been upheld in the absence of fraud or overreaching. *Houghland v. Security Alarms & Servs., Inc.*, 755 S.W.2d 769, 773 (Tenn. 1988). Consistent with the parties' freedom to construct their own bargain, they are free to allocate liability for future damages, provided that such clauses do not violate public policy. *Planters Gin Co. v Federal Compress & Warehouse Co.*, 78 S.W.3d 885, 892 (Tenn. 2002); cf. Tenn. Code Ann. § 62-6-123 (clauses in which one party promises to indemnify or hold harmless a party who is constructing [sic], repairing, or performing other work on a building or structure are void as against public policy). Furthermore, limitations of liability in alarm service contracts have

been enforced by this state's highest court, as well as the courts of many other jurisdictions. [Long string-cite omitted.]

[¶20] In *Houghland*, the Tennessee Supreme Court upheld the validity of an alarm services contract with terms very similar to those agreed to by National Alarm and Ms. Underwood, describing the contract as follows:

The original contract recited that Security Alarms was not in the business of writing burglary or other kinds of insurance. . . . The contract also contained a liquidated damages clause which fixed the liability of appellant at a specified sum. This amount was agreed upon as liquidated damages and as the exclusive remedy unless the subscriber desired the appellant to assume greater liability on a graduated scale of increasing rates. No such additional coverage was purchased by the subscribers.

755 S.W.2d at 771. After determining that there was no proof of fraud or intentional misrepresentation by the alarm company, the Court found the liquidated damages clause to be a valid limitation upon any recovery by the homeowners. *Id.* at 774.

[¶21] In the case at bar, Ms. Underwood signed a contract with language that bears a remarkable likeness to the contract at issue in *Houghland*. By signing the contract, Ms. Underwood acknowledged that National Alarm was not an insurer of property. The contract also provided that, in the event National Alarm was held liable for any loss relating to the provision of alarm services under the terms of the contract, then National Alarm's liability would be limited to \$ 250. The contract further stated that the sum was liquidated damages, not a penalty, and that the remedy was exclusive. Ms. Underwood had the opportunity to pay an additional fee for National Alarm to assume greater liability than the \$ 250 limit established by the contract; however, she opted not to incur the extra expense.

[¶22] Ms. Underwood has not alleged any fraud or intentional misrepresentation that might provide this Court with justification for voiding the contract or any portion thereof. Although this may be a harsh result, given the substantial damages sustained by Ms. Underwood and her family in the house fire, we are bound by precedent to enforce the liquidated damages clause that was signed by Ms. Underwood and a National Alarm representative.

[¶23] In the alternative, Ms. Underwood argues that the liquidated damages clause is ambiguous and therefore, pursuant to the rules of contract interpretation, should be construed against the drafter. This is a correct statement of the law; however, we find it inapplicable to this contract. There is no ambiguity in the limitation of liability at issue in this case; indeed, it is a very sweeping and all-inclusive clause. The allegations of wrongful conduct made by Ms. Underwood fall within the scope of this clause. Therefore, Ms. Underwood's recovery, if any, is limited to \$ 250.

C. Genuine Issue of Material Fact

[¶24] The trial court found that National Alarm had established that it was not negligent and Ms. Underwood did not present any evidence to create a genuine issue of material fact for trial. We disagree. * * * *

V. Conclusion

[¶25] After careful review, we hold that the trial court erred by granting summary judgment to National Alarm. However, we affirm the trial court's ruling that the limitation of liability/liquidated damages clause is valid. We vacate and remand this case to the trial court for further proceedings consistent with this opinion. Costs of appeal are taxed against the Appellee, National Alarm Services, Inc.

Questions:

1. Ms. Underwood promised to pay the monthly charge, and National Alarm promised to do whatever it promised to do. Yet Underwood did not pay the monthly fee after February, and the fire happened in July. Usually, mutual promises are constructive conditions. What does the court's holding regarding Ms. Underwood's failure to pay the fee imply about the way the court constructed the conditions? What role does the termination right play? You know enough to state the holding with much greater clarity than the court stated it.
2. On the limitation of remedy clause, several courts have now held that, though such a clause is enforceable with regard to the promisee's negligence, it will not be for the promisee's gross negligence. How comfortable are you that you can discern in advance the difference between ordinary and gross negligence? *See, e.g., Abacus Federal Savings Bank v. ADT Security Servs., Inc.*, 18 N.Y. 3d 675 (2012) (finding gross negligence possible on the facts alleged and reversing the Appellate Division (which found only ordinary negligence possible), reversing the Supreme Court (which found gross negligence possible)). If you as a judge dislike the holding in *Underwood*, how will that affect your thinking about gross negligence in alarm company cases?

D. Specific Performance

Richard A. ALBA et al. v. Jean-Claude KAUFMANN
N.Y. Supr. Ct. App. Div. (2006), 810 N.Y.S.2d 539

CREW III, J.

[¶1] Defendant is the owner of approximately 37 acres of real property located in the Town of Stephentown, Rensselaer County. The property, which contains a pond and is located in a wooded area, is improved with a 19th-century farmhouse. Defendant and his spouse, Christine Cacace, reside in New York City and use the Rensselaer County property as a weekend or vacation home.

[¶2] Defendant lost his full-time job in 1998 and, having apparently grown tired of the upkeep associated with maintaining an older home, decided to sell the property in 2001. Although defendant took the property off the market following the events of September 11, 2001, when Cacace lost her job in December 2003, financial considerations prompted defendant to again list the property for sale.

[¶3] Plaintiffs were shown defendant's property and, after brief negotiations, offered the full asking price of \$325,000. The parties executed a contract for sale in May 2004, and plaintiffs thereafter paid a deposit, obtained a mortgage commitment and, apparently, procured a satisfactory home inspection and title insurance. A closing was scheduled for July 15, 2004 but, on June 23, 2004, Cacace sent plaintiffs an e-mail indicating that she and defendant had "a change of heart" and no longer wished to go forward with the sale. Plaintiffs sent a reply e-mail two days later expressing their regret that the impending sale allegedly was causing Cacace distress, but indicating their intent to go forward with the scheduled closing. Cacace responded with another e-mail on June 27, 2004, this time informing plaintiffs that she suffered from multiple sclerosis and alleging that the "remorse and dread" over the impending sale was making her ill.

[¶4] When defendant refused to close, plaintiffs commenced this action seeking specific performance of the underlying real estate contract. Defendant answered and raised various affirmative defenses, including, insofar as is relevant to this appeal, that plaintiffs had an adequate remedy at law and that specific performance would lead to an inequitable result. Plaintiffs thereafter moved for summary judgment, but Supreme Court denied the motion, finding questions of fact regarding whether specific performance is plaintiffs' only remedy and whether performance of the contract would result in an unreasonable hardship. This appeal by plaintiffs ensued.

[¶5] There must be a reversal. In order to establish their entitlement to summary judgment, plaintiffs were required to demonstrate that they substantially performed their contractual obligations and were ready, willing and able to fulfill their remaining obligations, that defendant was able but unwilling to convey the property and that there is

no adequate remedy at law (see *EMF Gen. Contr. Corp. v Bisbee*, 6 A.D.3d 45, 51 [2004], lv dismissed 3 N.Y.3d 656 [2004], lv denied 3 N.Y.3d 607 [2004]; *Morgan v Eitt*, 111 A.D.2d 586, 587 [1985]). Plaintiffs plainly discharged that burden here. After executing the underlying contract, plaintiffs paid a deposit, obtained a mortgage commitment, demonstrated that they had the financial wherewithal to purchase what was to be for them a vacation home, obtained a satisfactory home inspection and procured title insurance. In short, the record demonstrates that plaintiffs were ready, willing and able to close on July 15, 2004 and, but for defendant's admitted refusal to do so, would have consummated the transaction.

[¶6] As to the remedy plaintiffs seek, the case law reveals that "the equitable remedy of specific performance is routinely awarded in contract actions involving real property, on the premise that each parcel of real property is unique" (*EMF Gen. Contr. Corp. v Bisbee*, supra at 52). Although certain defenses do exist including, insofar as is relevant here, unreasonable hardship, "the court's discretion to grant or deny specific performance of a contract for the sale of realty is not unlimited; unless the court finds that granting a decree of specific performance would be a drastic or harsh remedy, or work injustice, the court must direct specific performance" (id., quoting 91 NY Jur 2d, Real Property Sales and Exchanges § 204). Moreover, "[v]olitional unwillingness, as distinguished from good faith inability, to meet contractual obligations furnishes neither a ground for cancellation of the contract nor a defense against its specific performance" (*Meisels v 1295 Union Equities Corp.*, 306 A.D.2d 144, 145 [2003]).

[¶7] Here, defendant argues and Supreme Court found that summary judgment was inappropriate because defendant raised a question of fact as to the uniqueness of the property and, hence, whether plaintiffs had an adequate remedy at law, and further, whether ordering specific performance would work an undue hardship. We disagree. As noted previously, each parcel of real property is presumed to be unique (see *EMF Gen. Contr. Corp. v Bisbee*, supra at 52), and defendant's conclusory and self-serving assertion — unaccompanied by any evidence of comparable listings or sales — that there are many similar properties for sale in and around Rensselaer County is insufficient to raise a question of fact as to the uniqueness of the property. Hence, in our view, Supreme Court erred in finding that defendant tendered sufficient admissible proof to raise a question of fact as to whether plaintiffs had an adequate remedy at law.

[¶8] We reach a similar conclusion with regard to defendant's claim of undue hardship. Defendant's entire argument on this point is premised upon the allegedly deleterious effects that the impending sale of the property had upon Cacace's health. Specifically, defendant contends that the stress from the proposed sale exacerbated Cacace's fatigue and other physical symptoms of her disease. It is critical to note, however, that Cacace is not a titled owner of the property in question, nor is she a signatory to the underlying real estate contract. Thus, defendant is asking this Court to effectively set aside his contractual obligations not because the proposed sale allegedly constitutes an undue hardship for him

but, rather, because of the purported effect such sale would have upon his wife. This we cannot do.

[¶9] Even accepting, for purposes of this discussion, that the alleged exacerbation of Cacace's symptoms is both genuine and causally related to the proposed sale of property, as she is not a party to the contract, her connection to the transaction is simply too attenuated for defendant to claim undue hardship. In our view, permitting a third party who is not a signatory to a real estate contract, such as a spouse or, potentially, a child, sibling or parent, to assert, via the titled owner, an undue hardship claim by voicing objection to or otherwise contending that the proposed sale is simply too much to bear would interject uncertainty and chaos into the otherwise orderly world of contract law. Simply put, permitting a defendant to raise an undue hardship defense under the circumstances present here would place a nearly impossible burden upon potential purchasers of real property — namely, to ascertain whether any of the signatories' relatives had any potential objection to the sale in question.

[¶10] Moreover, even if we were to accept defendant's premise that the sanctity of the marital relationship and Cacace's longstanding attachment to the property at issue could form the basis for him to claim undue hardship, the medical evidence submitted in opposition to plaintiffs' motion falls far short of its mark. Preliminarily, we note that even Cacace acknowledged in her June 27, 2004 e-mail to plaintiffs regarding the then impending sale that she had received "assurances by all that [she would] get over it," and her e-mail suggests that those assurances were derived, in part, from professional counseling sessions. Additionally, the affidavit from defendant's expert, Daniel Silverman, who admittedly based his opinion upon the assumption that the stress allegedly experienced by Cacace was sincere, establishes, at best, that such stress "could explain" the change in symptoms that Cacace described, "could explain" the increase in the degree of fatigue Cacace purportedly experienced and "could account" for the increased limb weakness Cacace reported. And the unsworn letter from Cacace's treating physician, even if considered, reflects only that "[a]n increased level of stress can have the potential of exacerbating multiple sclerosis." To interpret such statements as drawing any sort of definitive correlation between the proposed sale and the onset or exacerbation of Cacace's symptoms would be entirely speculative. Thus, in our view, the record as a whole fails to contain sufficient admissible proof to raise a question of fact as to whether Cacace's medical condition constitutes an undue hardship for defendant. Accordingly, Supreme Court erred in denying plaintiffs' motion for summary judgment.

Ordered that the order is reversed, on the law, with costs, and plaintiffs' motion granted.

Questions:

1. The presumption of a real estate parcel's uniqueness is traditionally hard to overcome. It has been questioned in a few decisions. With what kind of real estate should it be most vulnerable?
2. Was the care with which the court discussed Ms. Cacace's health warranted by her arguments? Why did the court do that? How would you have dealt with it?

NORTHERN INDIANA PUBLIC SERVICE CO. v. CARBON CTY. COAL CO.
7th Cir. U.S. Ct. App. (1986), 799 F.2d 265

POSNER, Circuit.Judge.

[¶1] These appeals bring before us various facets of a dispute between Northern Indiana Public Service Company (NIPSCO), an electric utility in Indiana, and Carbon County Coal Company, a partnership that until recently owned and operated a coal mine in Wyoming. In 1978 NIPSCO and Carbon County signed a contract whereby Carbon County agreed to sell and NIPSCO to buy approximately 1.5 million tons of coal every year for 20 years, at a price of \$24 a ton subject to various provisions for escalation which by 1985 had driven the price up to \$44 a ton.

[¶2] NIPSCO's rates are regulated by the Indiana Public Service Commission. In 1983 NIPSCO requested permission to raise its rates to reflect increased fuel charges. Some customers of NIPSCO opposed the increase on the ground that NIPSCO could reduce its overall costs by buying more electrical power from neighboring utilities for resale to its customers and producing less of its own power. Although the Commission granted the requested increase, it directed NIPSCO, in orders issued in December 1983 and February 1984 (the "economy purchase orders"), to make a good faith effort to find, and wherever possible buy from, utilities that would sell electricity to it at prices lower than its costs of internal generation. The Commission added ominously that "the adverse effects of entering into long-term coal supply contracts which do not allow for renegotiation and are not requirement contracts, is a burden which must rest squarely on the shoulders of NIPSCO management." Actually the contract with Carbon County did provide for renegotiation of the contract price—but one-way renegotiation in favor of Carbon County; the price fixed in the contract (as adjusted from time to time in accordance with the escalator provisions) was a floor. And the contract was indeed not a requirements contract: it specified the exact amount of coal that NIPSCO must take over the 20 years during which the contract was to remain in effect. NIPSCO was eager to have an assured supply of low-sulphur coal and was therefore willing to guarantee both price and quantity.

[¶3] Unfortunately for NIPSCO, as things turned out it was indeed able to buy electricity at prices below the costs of generating electricity from coal bought under the contract with

Carbon County; and because of the "economy purchase orders," of which it had not sought judicial review, NIPSCO could not expect to be allowed by the Public Service Commission to recover in its electrical rates the costs of buying coal from Carbon County. NIPSCO therefore decided to stop accepting coal deliveries from Carbon County, at least for the time being; and on April 24, 1985, it brought this diversity suit against Carbon County in a federal district court in Indiana, seeking a declaration that it was excused from its obligations under the contract either permanently or at least until the economy purchase orders ceased preventing it from passing on the costs of the contract to its ratepayers. In support of this position it argued that the contract violated section 2(c) of the Mineral Lands Leasing Act of 1920, 30 U.S.C. § 202, because of Carbon County's affiliation with a railroad (Union Pacific), and that in any event NIPSCO's performance was excused or suspended — either under the contract's force majeure clause or under the doctrines of frustration or impossibility — by reason of the economy purchase orders.

[¶4] On May 17, 1985, Carbon County counterclaimed for breach of contract and moved for a preliminary injunction requiring NIPSCO to continue taking delivery under the contract. On June 19, 1985, the district judge granted the preliminary injunction, from which NIPSCO has appealed. Also on June 19, rejecting NIPSCO's argument that it needed more time for pretrial discovery and other trial preparations, the judge scheduled the trial to begin on August 26, 1985. Trial did begin then, lasted for six weeks, and resulted in a jury verdict for Carbon County of \$181 million. The judge entered judgment in accordance with the verdict, rejecting Carbon County's argument that in lieu of damages it should get an order of specific performance requiring NIPSCO to comply with the contract. Upon entering the final judgment the district judge dissolved the preliminary injunction, and shortly afterward the mine—whose only customer was NIPSCO—shut down. NIPSCO has appealed from the damage judgment, and Carbon County from the denial of specific performance and from the district judge's order staying execution of the damage judgment without requiring NIPSCO to post a bond guaranteeing payment of the judgment should NIPSCO lose on appeal. * * * *

[¶5] This completes our consideration of NIPSCO's attack on the damages judgment and we turn to Carbon County's cross-appeal, which seeks specific performance in lieu of the damages it got. Carbon County's counsel virtually abandoned the cross-appeal at oral argument, noting that the mine was closed and could not be reopened immediately — so that if specific performance (i.e., NIPSCO's resuming taking the coal) was ordered, Carbon County would not be able to resume its obligations under the contract without some grace period. In any event the request for specific performance has no merit. Like other equitable remedies, specific performance is available only if damages are not an adequate remedy, Farnsworth, *supra*, § 12.6, and there is no reason to suppose them inadequate here. The loss to Carbon County from the breach of contract is simply the difference between (1) the contract price (as escalated over the life of the contract in accordance with the contract's escalator provisions) times quantity, and (2) the cost of mining the coal over the life of the contract. Carbon County does not even argue that \$181 million is not a reasonable estimate of the present value of the difference. Its complaint is that although the money will make

the owners of Carbon County whole it will do nothing for the miners who have lost their jobs because the mine is closed and the satellite businesses that have closed for the same reason. Only specific performance will help them.

[¶6] But since they are not parties to the contract their losses are irrelevant. Indeed, specific performance would be improper as well as unnecessary here, because it would force the continuation of production that has become uneconomical. Cf. Farnsworth, *supra*, at 817-18. No one wants coal from Carbon County's mine. With the collapse of oil prices, which has depressed the price of substitute fuels as well, this coal costs far more to get out of the ground than it is worth in the market. Continuing to produce it, under compulsion of an order for specific performance, would impose costs on society greater than the benefits. NIPSCO's breach, though it gave Carbon County a right to damages, was an efficient breach in the sense that it brought to a halt a production process that was no longer cost-justified. See *Lake River Corp. v. Carborundum Co.*, 769 F.2d 1284, 1289 (7th Cir.1985); *Thyssen, Inc. v. S.S. Fortune Star*, 777 F.2d 57, 63 (2d Cir.1985) (Friendly, J.). The reason why NIPSCO must pay Carbon County's loss is not that it should have continued buying coal it didn't need but that the contract assigned to NIPSCO the risk of market changes that made continued deliveries uneconomical. The judgment for damages is the method by which that risk is being fixed on NIPSCO in accordance with its undertakings.

[¶7] With continued production uneconomical, it is unlikely that an order of specific performance, if made, would ever actually be implemented. If, as a finding that the breach was efficient implies, the cost of a substitute supply (whether of coal, or of electricity) to NIPSCO is less than the cost of producing coal from Carbon County's mine, NIPSCO and Carbon County can both be made better off by negotiating a cancellation of the contract and with it a dissolution of the order of specific performance. Suppose, by way of example, that Carbon County's coal costs \$20 a ton to produce, that the contract price is \$40, and that NIPSCO can buy coal elsewhere for \$10. Then Carbon County would be making a profit of only \$20 on each ton it sold to NIPSCO (\$40-\$20), while NIPSCO would be losing \$30 on each ton it bought from Carbon County (\$40-\$10). Hence by offering Carbon County more than contract damages (i.e., more than Carbon County's lost profits), NIPSCO could induce Carbon County to discharge the contract and release NIPSCO to buy cheaper coal. For example, at \$25, both parties would be better off than under specific performance, where Carbon County gains only \$20 but NIPSCO loses \$30. Probably, therefore, Carbon County is seeking specific performance in order to have bargaining leverage with NIPSCO, and we can think of no reason why the law should give it such leverage. We add that if Carbon County obtained and enforced an order for specific performance this would mean that society was spending \$20 (in our hypothetical example) to produce coal that could be gotten elsewhere for \$10 — a waste of scarce resources.

[¶8] As for possible hardships to workers and merchants in Hanna, Wyoming, where Carbon County's coal mine is located, we point out that none of these people were parties to the contract with NIPSCO or third-party beneficiaries. They have no legal interest in the contract. Cf. *Local 1330, United Steel Workers of America v. United States Steel Corp.*,

631 F.2d 1264, 1279-82 (6th Cir.1980); *Serrano v. Jones & Laughlin Steel Co.*, 790 F.2d 1279, 1289 (6th Cir.1986). Of course the consequences to third parties of granting an injunctive remedy, such as specific performance, must be considered, and in some cases may require that the remedy be withheld. See *Weinberger v. Romero-Barcelo*, 456 U.S. 305, 312-13, 102 S.Ct. 1798, 1803, 72 L.Ed.2d 91 (1982); *Shondel v. McDermott*, 775 F.2d 859, 868 (7th Cir.1985); *Duran v. Elrod*, 760 F.2d 756, 759 (7th Cir.1985); *Donovan v. Robbins*, 752 F.2d 1170, 1176 (7th Cir.1985). The frequent references to "public interest" as a factor in the grant or denial of a preliminary injunction invariably are references to third-party effects. See, e.g., *Punnett v. Carter*, 621 F.2d 578, 587-88 (3d Cir.1980). But even though the formal statement of the judicial obligation to consider such effects extends to orders denying as well as granting injunctive relief, see, e.g., *Kershner v. Mazurkiewicz*, 670 F.2d 440, 443 (3d Cir.1982) (en banc), the actuality is somewhat different: when the question is whether third parties would be injured by an order denying an injunction, always they are persons having a legally recognized interest in the lawsuit, so that the issue really is the adequacy of relief if the injunction is denied. In *Mississippi Power & Light Co. v. United Gas Pipe Line Co.*, 760 F.2d 618 (5th Cir.1985), for example, a public utility sought a preliminary injunction against alleged overcharges by a supplier. If the injunction was denied and later the utility got damages, its customers would be entitled to refunds; but for a variety of reasons explained in the opinion, refunds would not fully protect the customers' interests. The customers were the real parties in interest on the plaintiff side of the case, and their interests had therefore to be taken into account in deciding whether there would be irreparable harm (and how much) if the preliminary injunction was denied. See *id.* at 623-26. Carbon County does not stand in a representative relation to the workers and businesses of Hanna, Wyoming. Treating them as real parties in interest would evade the limitations on the concept of a third-party beneficiary and would place the promisor under obligations potentially far heavier than it had thought it was accepting when it signed the contract. Indeed, if we are right that an order of specific performance would probably not be carried out — that instead NIPSCO would pay an additional sum of money to Carbon County for an agreement not to enforce the order — it becomes transparent that granting specific performance would make NIPSCO liable in money damages for harms to nonparties to the contract, and it did not assume such liability by signing the contract. Cf. *H.R. Moch Co. v. Rensselaer Water Co.*, 247 N.Y. 160, 159 N.E. 896 (1928).

[¶9] Moreover, the workers and merchants in Hanna assumed the risk that the coal mine would have to close down if it turned out to be uneconomical. The contract with NIPSCO did not guarantee that the mine would operate throughout the life of the contract but only protected the owners of Carbon County against the financial consequences to them of a breach. As Carbon County itself emphasizes in its brief, the contract was a product of the international oil cartel, which by forcing up the price of substitute fuels such as coal made costly coal-mining operations economically attractive. The OPEC cartel is not a source of vested rights to produce substitute fuels at inflated prices. * * * *

[¶10] To summarize, the appeal from the grant of the preliminary injunction is dismissed as moot; the other orders appealed from are affirmed. No costs will be awarded in this court, since we have turned down Carbon County's appeals as well as NIPSCO's.

SO ORDERED.

Questions:

1. Why does Posner think that imposing specific performance on NIPSCO would not force CCCC to produce coal?
2. Why does Posner claim that forcing CCCC to take coal from the ground would impose “costs on society greater than the benefits”?
3. Why in such a contract should specific performance not be ordered?
4. How does Posner know that the parties will settle out and not perform the injunction?
5. Why does Posner say that NIPSCO must pay damages? Why is there normally a damages right?
6. Do you think that Posner is right that CCCC did not enter into this contract in order to produce coal?
7. The contract at issue here is a sale of goods. Why do you suppose the court does not even mention UCC § 2-716?

BEVERLY GLEN MUSIC, INC. v. WARNER COMMUNICATIONS, INC.
Cal. App. (1986), 178 Cal. App. 3d 1143

OPINION

KINGSLEY, Acting P. J.

[¶1] The plaintiff appeals from an order denying a preliminary injunction against the defendant, Warner Communications, Inc. We affirm.

Facts

[¶2] In 1982, plaintiff Beverly Glen Music, Inc., signed to a contract a then-unknown singer, Anita Baker. Ms. Baker recorded an album for Beverly Glen which was moderately successful, grossing over \$1 million. In 1984, however, Ms. Baker was offered a considerably better deal by defendant Warner Communications. As she was having some difficulties with Beverly Glen, she accepted Warner's offer and notified plaintiff that she was no longer willing to perform under the contract. Beverly Glen then sued Ms. Baker and sought to have her enjoined from performing for any other recording studio. The injunction was denied, however, as, under Civil Code section 3423, subdivision Fifth, California courts will not enjoin the breach of a personal service contract unless the service is unique in nature and the performer is guaranteed annual compensation of at least \$6,000, which Ms. Baker was not.

[¶3] Following this ruling, the plaintiff voluntarily dismissed the action against Ms. Baker. Plaintiff, however, then sued Warner Communications for inducing Ms. Baker to breach her contract and moved the court for an injunction against Warner to prevent it from employing her. This injunction, too, was denied, the trial court reasoning that what one was forbidden by statute to do directly, one could not accomplish through the back door. It is from this ruling that the plaintiff appeals.

Discussion

[¶4] From what we can tell, this is a case of first impression in California. While there are numerous cases on the general inability of an employer to enjoin his former employee from performing services somewhere else, apparently no one has previously thought of enjoining the new employer from accepting the services of the breaching employee. While we commend the plaintiff for its resourcefulness in this regard, we concur in the trial court's interpretation of the maneuver.

[¶5] "It is a familiar rule that a contract to render personal services cannot be specifically enforced." (Foxy v. Williams (1966) 244 Cal.App.2d 223, 235 [52 Cal.Rptr. 896].) An unwilling employee cannot be compelled to continue to provide services to his employer either by ordering specific performance of his contract, or by injunction. To do so runs afoul of the Thirteenth Amendment's prohibition against involuntary servitude. (Poultry Producers etc. v. Barlow (1922) 189 Cal.278, 288 [208 P. 93].) However, beginning with the English case of Lumley v. Wagner (1852) 42 Eng. Rep. 687, courts have recognized that, while they cannot directly enforce an affirmative promise (in the Lumley case, Miss Wagner's promise to perform at the plaintiff's opera house), they can enforce the negative promise implied therein (that the defendant would not perform for someone else that evening). Thus, while it is not possible to compel a defendant to perform his duties under a personal service contract, it is possible to prevent him from employing his talents anywhere else. The net effect is to pressure the defendant to return voluntarily to his employer by denying him the means of earning a living. Indeed, this is its only purpose,

for, unless the defendant relents and honors the contract, the plaintiff gains nothing from having brought the injunction.

[¶6] The California Legislature, however, did not adopt this principle when in 1872 it enacted Civil Code section 3423, subdivision Fifth, and Code of Civil Procedure section 526, subdivision 5. These sections both provided that an injunction could not be granted: "To prevent the breach of a contract the performance of which would not be specifically enforced." In 1919, however, these sections were amended, creating an exception for: "a contract in writing for the rendition or furnishing of personal services from one to another where the minimum compensation for such service is at the rate of not less than six thousand dollars per annum and where the promised service is of a special, unique, unusual, extraordinary or intellectual character . . .".

[¶7] The plaintiff has already unsuccessfully argued before the trial court that Ms. Baker falls within this exception. It has chosen not to appeal that judgment, and is therefore barred from questioning that determination now. The sole issue before us then is whether plaintiff—although prohibited from enjoining Ms. Baker from performing herself—can seek to enjoin all those who might employ her and prevent them from doing so, thus achieving the same effect.

[¶8] We rule that plaintiff cannot. Whether plaintiff proceeds against Ms. Baker directly or against those who might employ her, the intent is the same: to deprive Ms. Baker of her livelihood and thereby pressure her to return to plaintiff's employ. Plaintiff contends that this is not an action against Ms. Baker but merely an equitable claim against Warner to deprive it of the wrongful benefits it gained when it "stole" Ms. Baker away. Thus, plaintiff contends, the equities lie not between the plaintiff and Ms. Baker, but between plaintiff and the predatory Warner Communications company. Yet if Warner's behavior has actually been predatory, plaintiff has an adequate remedy by way of damages. An injunction adds nothing to plaintiff's recovery from Warner except to coerce Ms. Baker to honor her contract. Denying someone his livelihood is a harsh remedy. The Legislature has forbidden it but for one exception. To expand this remedy so that it could be used in virtually all breaches of a personal service contract is to ignore over 100 years of common law on this issue. We therefore decline to reverse the order.

The order is affirmed.

Question: Though Ms. Baker was successful, other performers have not been, including boxer Ernie Shavers, *Madison Square Garden Boxing, Inc. v. Shavers*, 434 F. Supp. 449 (S.D.N.Y. 1977); singer James Brown, *King Records v. Brown*, 252 N.Y.S.2d 988 (Supr. Ct. App. Div. (1964)); and actress Bette Davis, *Warner Bros. Pictures, Inc. v. Nelson*, [1937] 1 K.B. 209 (Eng.) (1936) 3 All E.R. 160. One performer, William Comstock (known as "Billy House"), before being ordered not to perform, went so far as to claim that his services were not unique. *Harry Rogers Theatrical Enterps. v. Comstock*, 232 N.Y.S. 1 (Supr. Ct. App. Div. 1928). However, a recital in his contract admitted that they were:

Next we have the uncontroverted fact that the ability of Comstock is regarded as unique upon the Albee-Keith circuit and that a substitute will not be accepted. Hence in this well-known vaudeville office Comstock cannot be replaced. Again, Comstock is now admittedly receiving a salary of \$1,000 a week, which, in his work, is very large and compares most favorably with that received by the leaders in the scientific, artistic, and political world.

232 N.Y.S. at 3. The court even cited the fact that Comstock's co-defendant, who had tried to hire Comstock away from Harry Rogers, "was willing to risk a lawsuit and pay \$1,000 a week to secure the services of Comstock." *Id.* at 4. Uniqueness, indeed. The court ended with a plea to basic reliance on the institution of contract:

If the time shall ever come when a court of equity must stand helplessly by while unique and unusual theatrical performers may be induced to breach contracts with impunity, except for such damages as a jury may see fit to award at some distant date, theatrical corporations will find their business hampered by intolerable conditions.

Id. Where should the line be between the performers' and promoters' interests?

E. Agreements to Arbitrate

The Federal Arbitration Act ("FAA") requires courts to enforce promises to arbitrate. The most important provisions are sections 2 and 3:

A written provision in * * * a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

Other provisions supplement. Section 4 provides a procedure to ask U.S. district courts to assist in compelling arbitration. Section 5 describes how arbitrators are chosen if the parties' agreement provides no means. Section 7 empowers arbitrators to compel witnesses or other evidence and gives U.S. district courts power to enforce arbitrators' summonses under threat of contempt. Section 9 specifies how an arbitration award can be enforced in court:

If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, and shall specify the court, then at any time within one year after the award is made any party to the arbitration may apply to the court so specified for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title.

A judicially confirmed arbitration award is enforceable as a judgment of the court itself.

Because an arbitration award does not have the backing of the state or federal government until a judge confirms the award, one might think that there would be a chance for judicial review of what the arbitrator does. This would be mistaken. Section 10, which names the substantive grounds for vacatur of arbitration awards,^{*} allows relief only where “the award was procured by corruption, fraud, or undue means” or there was some misconduct by the arbitrators, including “where the arbitrators exceeded their powers.” When do arbitrators exceed their powers? The US Supreme Court has held that they do not exceed their powers when they err in discerning or applying the law, even if they commit “a serious error.” *Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp.*, 559 U.S. 662, 671 (2010). But there are limits. *Stolt-Nielsen S.A.* reversed a decision of arbitrators reached not on the basis of the contract, the FAA, or state or federal law but in which the arbitration panel “imposed its own policy preference.” *Id.* at 676. The Court condemned the panel because it “proceeded as if it had the authority of a common-law court to develop what it viewed as the best rule to be applied in such a situation.” *Id.* at 673-74. The Court declined to decide whether another standard for vacating arbitration awards existed: “manifest disregard for the law.” *Id.* at 672 n.3. This has been defined as where arbitrators “knew of the relevant [legal] principle, appreciated that this principle controlled the outcome of the disputed issue, and nonetheless willfully flouted the governing law by refusing to apply it.” *Id.* (internal quotations omitted). Some courts have applied such a standard under the FAA. But the Court said that, if such a standard does exist, it was met in *Stolt-Nielsen S.A.* *Id.* In any event, so long as the arbitrators do not appear to be making law or flouting clear law, their errors are irrelevant.

For a while, it was not clear that the FAA was enforceable in state court (meaning that state courts were required to follow it), but the US Supreme Court made clear that it was in *Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983). State law also often mandates agreed-upon arbitration, so state courts have their own opinions about what should be arbitrable. Not surprisingly, the policy choices made by state law actors do not always accord with what the federal courts see as required by the FAA. The following two cases address some disjuncts.

^{*} Section 11 names grounds for “modifying or correcting” an award for largely formal errors “so as to effect the intent thereof and promote justice between the parties.”

BUCKEYE CHECK CASHING, INC. v. CARDEGNA
U.S. (2005), 546 U.S. 440

JUSTICE SCALIA delivered the opinion of the Court.

[¶1] We decide whether a court or an arbitrator should consider the claim that a contract containing an arbitration provision is void for illegality.

I

[¶2] Respondents John Cardegna and Donna Reuter entered into various deferred-payment transactions with petitioner Buckeye Check Cashing (Buckeye), in which they received cash in exchange for a personal check in the amount of the cash plus a finance charge. For each separate transaction they signed a “Deferred Deposit and Disclosure Agreement” (Agreement), which included the following arbitration provisions:

“1. *Arbitration Disclosure* By signing this Agreement, you agree that i[f] a dispute of any kind arises out of this Agreement or your application therefore or any instrument relating thereto, th[e]n either you or we or third-parties involved can choose to have that dispute resolved by binding arbitration as set forth in Paragraph 2 below

2. *Arbitration Provisions* Any claim, dispute, or controversy . . . arising from or relating to this Agreement . . . or the validity, enforceability, or scope of this Arbitration Provision or the entire Agreement (collectively ‘Claim’), shall be resolved, upon the election of you or us or said third-parties, by binding arbitration This arbitration Agreement is made pursuant to a transaction involving interstate commerce, and shall be governed by the Federal Arbitration Act (‘FAA’), 9 U. S. C. Sections 1–16. The arbitrator shall apply applicable substantive law constraint [sic] with the FAA and applicable statu[t]es of limitations and shall honor claims of privilege recognized by law”

[¶3] Respondents brought this putative class action in Florida state court, alleging that Buckeye charged usurious interest rates and that the Agreement violated various Florida lending and consumer-protection laws, rendering it criminal on its face. Buckeye moved to compel arbitration. The trial court denied the motion, holding that a court rather than an arbitrator should resolve a claim that a contract is illegal and void ab initio. The District Court of Appeal of Florida for the Fourth District reversed, holding that because respondents did not challenge the arbitration provision itself, but instead claimed that the entire contract was void, the agreement to arbitrate was enforceable, and the question of the contract’s legality should go to the arbitrator.

[¶4] Respondents appealed, and the Florida Supreme Court reversed, reasoning that to enforce an agreement to arbitrate in a contract challenged as unlawful “ ‘could breathe life into a contract that not only violates state law, but also is criminal in nature’ ” 894 So.

2d 860, 862 (2005) (quoting *Party Yards, Inc. v. Templeton*, 751 So. 2d 121, 123 (Fla. App. 2000)). We granted certiorari. 545 U. S. ____ (2005).

II

A

[¶5] To overcome judicial resistance to arbitration, Congress enacted the Federal Arbitration Act (FAA), 9 U. S. C. §§1–16. Section 2 embodies the national policy favoring arbitration and places arbitration agreements on equal footing with all other contracts:

“A written provision in . . . a contract . . . to settle by arbitration a controversy thereafter arising out of such contract . . . or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”

Challenges to the validity of arbitration agreements “upon such grounds as exist at law or in equity for the revocation of any contract” can be divided into two types. One type challenges specifically the validity of the agreement to arbitrate. See, e.g., *Southland Corp. v. Keating*, 465 U. S. 1, 4–5 (1984) (challenging the agreement to arbitrate as void under California law insofar as it purported to cover claims brought under the state Franchise Investment Law). The other challenges the contract as a whole, either on a ground that directly affects the entire agreement (e.g., the agreement was fraudulently induced), or on the ground that the illegality of one of the contract’s provisions renders the whole contract invalid.* Respondents’ claim is of this second type. The crux of the complaint is that the contract as a whole (including its arbitration provision) is rendered invalid by the usurious finance charge.

[¶6] In *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U. S. 395 (1967), we addressed the question of who—court or arbitrator—decides these two types of challenges. The issue in the case was “whether a claim of fraud in the inducement of the entire contract is to be resolved by the federal court, or whether the matter is to be referred to the arbitrators.” *Id.*, at 402. Guided by §4 of the FAA, we held that “if the claim is fraud in the inducement of the arbitration clause itself—an issue which goes to the making of the agreement to arbitrate—the federal court may proceed to adjudicate it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally.” *Id.*, at 403–404 (internal quotation marks and footnote omitted). We rejected the view that the question of “severability” was one of state law, so that if state

* The issue of the contract’s validity is different from the issue of whether any agreement between the alleged obligor and obligee was ever concluded. Our opinion today addresses only the former, and does not speak to the issue decided in the cases cited by respondents (and by the Florida Supreme Court), which hold that it is for courts to decide whether the alleged obligor ever signed the contract, *Chastain v. Robinson-Humphrey Co.*, 957 F. 2d 851 (CA11 1992), whether the signor lacked authority to commit the alleged principal, *Sandvik AB v. Advent Int’l Corp.*, 220 F. 3d 99 (CA3 2000); *Sphere Drake Ins. Ltd. v. All American Ins. Co.*, 256 F. 3d 587 (CA7 2001), and whether the signor lacked the mental capacity to assent, *Spahr v. Secco*, 330 F. 3d 1266 (CA10 2003).

law held the arbitration provision not to be severable a challenge to the contract as a whole would be decided by the court. See *id.*, at 400, 402–403.

[¶7] Subsequently, in *Southland Corp.*, we held that the FAA “create[d] a body of federal substantive law,” which was “applicable in state and federal court.” 465 U. S., at 12 (internal quotation marks omitted). We rejected the view that state law could bar enforcement of §2, even in the context of state-law claims brought in state court. See *id.*, at 10–14; see also *Allied-Bruce Terminix Cos. v. Dobson*, 513 U. S. 265, 270–273 (1995).

B

[¶8] *Prima Paint* and *Southland* answer the question presented here by establishing three propositions. First, as a matter of substantive federal arbitration law, an arbitration provision is severable from the remainder of the contract. Second, unless the challenge is to the arbitration clause itself, the issue of the contract’s validity is considered by the arbitrator in the first instance. Third, this arbitration law applies in state as well as federal courts. The parties have not requested, and we do not undertake, reconsideration of those holdings. Applying them to this case, we conclude that because respondents challenge the Agreement, but not specifically its arbitration provisions, those provisions are enforceable apart from the remainder of the contract. The challenge should therefore be considered by an arbitrator, not a court.

[¶9] In declining to apply *Prima Paint*’s rule of severability, the Florida Supreme Court relied on the distinction between void and voidable contracts. “Florida public policy and contract law,” it concluded, permit “no severable, or salvageable, parts of a contract found illegal and void under Florida law.” 894 So. 2d, at 864. *Prima Paint* makes this conclusion irrelevant. That case rejected application of state severability rules to the arbitration agreement without discussing whether the challenge at issue would have rendered the contract void or voidable. See 388 U. S., at 400–404. Indeed, the opinion expressly disclaimed any need to decide what state-law remedy was available, *id.*, at 400, n. 3, (though Justice Black’s dissent asserted that state law rendered the contract void, *id.*, at 407). Likewise in *Southland*, which arose in state court, we did not ask whether the several challenges made there—fraud, misrepresentation, breach of contract, breach of fiduciary duty, and violation of the California Franchise Investment Law—would render the contract void or voidable. We simply rejected the proposition that the enforceability of the arbitration agreement turned on the state legislature’s judgment concerning the forum for enforcement of the state-law cause of action. See 465 U. S., at 10. So also here, we cannot accept the Florida Supreme Court’s conclusion that enforceability of the arbitration agreement should turn on “Florida public policy and contract law,” 894 So. 2d, at 864.

[¶10] * * * * Respondents point to the language of §2, which renders “valid, irrevocable, and enforceable” “a written provision in” or “an agreement in writing to submit to arbitration an existing controversy arising out of” a “contract.” Since, respondents argue, the only arbitration agreements to which §2 applies are those involving a “contract,” and since an agreement void *ab initio* under state law is not a “contract,” there is no “written provision” in or “controversy arising out of” a “contract,” to which §2 can apply. This argument echoes Justice Black’s dissent in *Prima Paint*: “Sections 2 and 3 of the Act assume the existence of a valid contract. They merely provide for enforcement where such a valid contract exists.” 388 U. S., at 412–413. We do not read “contract” so narrowly. The word appears four times in §2. Its last appearance is in the final clause, which allows a challenge to an arbitration provision “upon such grounds as exist at law or in equity for the revocation of any contract.” (Emphasis added.) There can be no doubt that “contract” as used this last time must include contracts that later prove to be void. Otherwise, the grounds for revocation would be limited to those that rendered a contract voidable—which would mean (implausibly) that an arbitration agreement could be challenged as voidable but not as void. Because the sentence’s final use of “contract” so obviously includes putative contracts, we will not read the same word earlier in the same sentence to have a more narrow meaning.* We note that neither *Prima Paint* nor *Southland* lends support to respondents’ reading; as we have discussed, neither case turned on whether the challenge at issue would render the contract voidable or void.

* * *

[¶11] It is true, as respondents assert, that the *Prima Paint* rule permits a court to enforce an arbitration agreement in a contract that the arbitrator later finds to be void. But it is equally true that respondents’ approach permits a court to deny effect to an arbitration provision in a contract that the court later finds to be perfectly enforceable. *Prima Paint* resolved this conundrum—and resolved it in favor of the separate enforceability of arbitration provisions. We reaffirm today that, regardless of whether the challenge is brought in federal or state court, a challenge to the validity of the contract as a whole, and not specifically to the arbitration clause, must go to the arbitrator.

[¶12] The judgment of the Florida Supreme Court is reversed, and the case is remanded for further proceedings not inconsistent with this opinion.

* Our more natural reading is confirmed by the use of the word “contract” elsewhere in the United States Code to refer to putative agreements, regardless of whether they are legal. For instance, the Sherman Act, ch.647, 26 Stat. 209, as amended, states that “[e]very contract, combination . . . , or conspiracy, in restraint of trade [is] hereby declared to be illegal.” 15 U.S.C. § 1. Under respondents’ reading of “contract,” a bewildering circularity would result: A contract illegal because it was in restraint of trade would not be a “contract” at all, and thus the statutory prohibition would not apply.

Questions:

1. Would lack of consideration for an agreement containing an arbitration clause be for the court or arbitrators to consider? Would this be different or the same as lack of assent addressed in the footnote? Why or why not?
2. If someone held a gun to your head and forced you to sign a contract containing an arbitration clause, where would you present that evidence—in court or to the arbitrators?
3. Is the arbitration term specifically enforceable? What justifies enforcing it specifically on principles different than other contract terms?

AT&T MOBILITY LLC v. CONCEPTION et ux.
U.S. (2011), 563 U.S. 333

JUSTICE SCALIA delivered the opinion of the Court.

[¶1] Section 2 of the Federal Arbitration Act (FAA) makes agreements to arbitrate “valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” 9 U. S. C. §2. We consider whether the FAA prohibits States from conditioning the enforceability of certain arbitration agreements on the availability of classwide arbitration procedures.

I

[¶2] In February 2002, Vincent and Liza Concepcion entered into an agreement for the sale and servicing of cellular telephones with AT&T Mobility LCC (AT&T). The contract provided for arbitration of all disputes between the parties, but required that claims be brought in the parties’ “individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding.” App. to Pet. for Cert 61a. [Footnote 2: That provision further states that “the arbitrator may not consolidate more than one person’s claims, and may not otherwise preside over any form of a representative or class proceeding.” App. to Pet. for Cert. 61a.] The agreement authorized AT&T to make unilateral amendments, which it did to the arbitration provision on several occasions. The version at issue in this case reflects revisions made in December 2006, which the parties agree are controlling.

[¶3] The revised agreement provides that customers may initiate dispute proceedings by completing a one-page Notice of Dispute form available on AT&T’s Web site. AT&T may then offer to settle the claim; if it does not, or if the dispute is not resolved within 30 days, the customer may invoke arbitration by filing a separate Demand for Arbitration, also available on AT&T’s Web site. In the event the parties proceed to arbitration, the agreement specifies that AT&T must pay all costs for nonfrivolous claims; that arbitration

must take place in the county in which the customer is billed; that, for claims of \$10,000 or less, the customer may choose whether the arbitration proceeds in person, by telephone, or based only on submissions; that either party may bring a claim in small claims court in lieu of arbitration; and that the arbitrator may award any form of individual relief, including injunctions and presumably punitive damages. The agreement, moreover, denies AT&T any ability to seek reimbursement of its attorney's fees, and, in the event that a customer receives an arbitration award greater than AT&T's last written settlement offer, requires AT&T to pay a \$7,500 minimum recovery [increased to \$10,000 in 2009—from footnote 3] and twice the amount of the claimant's attorney's fees.

[¶4] The Concepcions purchased AT&T service, which was advertised as including the provision of free phones; they were not charged for the phones, but they were charged \$30.22 in sales tax based on the phones' retail value. In March 2006, the Concepcions filed a complaint against AT&T in the United States District Court for the Southern District of California. The complaint was later consolidated with a putative class action alleging, among other things, that AT&T had engaged in false advertising and fraud by charging sales tax on phones it advertised as free.

[¶5] In March 2008, AT&T moved to compel arbitration under the terms of its contract with the Concepcions. The Concepcions opposed the motion, contending that the arbitration agreement was unconscionable and unlawfully exculpatory under California law because it disallowed classwide procedures. The District Court denied AT&T's motion. It described AT&T's arbitration agreement favorably, noting, for example, that the informal dispute resolution process was "quick, easy to use" and likely to "promptly full or . . . even excess payment to the customer without the need to arbitrate or litigate"; that the \$7,500 premium functioned as "a substantial inducement for the consumer to pursue the claim in arbitration" if a dispute was not resolved informally; and that consumers who were members of a class would likely be worse off. *Laster v. T-Mobile USA, Inc.*, 2008 WL 5216255, *11–*12 (SD Cal., Aug. 11, 2008). Nevertheless, relying on the California Supreme Court's decision in *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 113 P. 3d 1100 (2005), the court found that the arbitration provision was unconscionable because AT&T had not shown that bilateral arbitration adequately substituted for the deterrent effects of class actions. *Laster*, 2008 WL 5216255, *14.

[¶6] The Ninth Circuit affirmed, also finding the provision unconscionable under California law as announced in *Discover Bank*. *Laster v. AT&T Mobility LLC*, 584 F. 3d 849, 855 (2009). It also held that the *Discover Bank* rule was not preempted by the FAA because that rule was simply "a refinement of the unconscionability analysis applicable to contracts generally in California." 584 F. 3d, at 857. In response to AT&T's argument that the Concepcions' interpretation of California law discriminated against arbitration, the Ninth Circuit rejected the contention that "class proceedings will reduce the efficiency and expeditiousness of arbitration" and noted that "Discover Bank placed arbitration agreements with class action waivers on the exact same footing as contracts that bar class

action litigation outside the context of arbitration.” Id., at 858 (quoting *Shroyer v. New Cingular Wireless Services, Inc.*, 498 F. 3d 976, 990 (CA9 2007)).

[¶7] We granted certiorari, 560 U. S. ____ (2010).

II

[¶8] The FAA was enacted in 1925 in response to widespread judicial hostility to arbitration agreements. * * * Section 2, the “primary substantive provision of the Act,” *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U. S. 1, 24 (1983), provides, in relevant part, as follows:

“A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” 9 U. S. C. §2.

We have described this provision as reflecting both a “liberal federal policy favoring arbitration,” *Moses H. Cone*, supra, at 24, and the “fundamental principle that arbitration is a matter of contract,” *Rent-A-Center, West, Inc. v. Jackson*, 561 U. S. ____, ____ (2010) (slip op., at 3).

[¶9] In line with these principles, courts must place arbitration agreements on an equal footing with other contracts, *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U. S. 440, 443 (2006), and enforce them according to their terms, *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U. S. 468, 478 (1989).

[¶10] The final phrase of §2, however, permits arbitration agreements to be declared unenforceable “upon such grounds as exist at law or in equity for the revocation of any contract.” This saving clause permits agreements to arbitrate to be invalidated by “generally applicable contract defenses, such as fraud, duress, or unconscionability,” but not by defenses that apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue. *Doctor’s Associates, Inc. v. Casarotto*, 517 U. S. 681, 687 (1996); see also *Perry v. Thomas*, 482 U. S. 483, 492–493, n. 9 (1987). The question in this case is whether §2 preempts California’s rule classifying most collective-arbitration waivers in consumer contracts as unconscionable. We refer to this rule as the Discover Bank rule.

[¶11] Under California law, courts may refuse to enforce any contract found “to have been unconscionable at the time it was made,” or may “limit the application of any unconscionable clause.” Cal. Civ. Code Ann. §1670.5(a) (West 1985). A finding of unconscionability requires “a ‘procedural’ and a ‘substantive’ element, the former focusing on ‘oppression’ or ‘surprise’ due to unequal bargaining power, the latter on ‘overly harsh’ or ‘one-sided’ results.” *Armendariz v. Foundation Health Psychcare Servs., Inc.*, 24 Cal.

4th 83, 114, 6 P. 3d 669, 690 (2000); accord, *Discover Bank*, 36 Cal. 4th, at 159–161, 113 P. 3d, at 1108.

[¶12] In *Discover Bank*, the California Supreme Court applied this framework to class-action waivers in arbitration agreements and held as follows:

“[W]hen the waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money, then . . . the waiver becomes in practice the exemption of the party ‘from responsibility for [its] own fraud, or willful injury to the person or property of another.’ Under these circumstances, such waivers are unconscionable under California law and should not be enforced.” *Id.*, at 162, 113 P. 3d, at 1110 (quoting Cal. Civ. Code Ann. §1668).

California courts have frequently applied this rule to find arbitration agreements unconscionable. [String cite omitted.]

III A

[¶13] The Concepcions argue that the *Discover Bank* rule, given its origins in California’s unconscionability doctrine and California’s policy against exculpation, is a ground that “exist[s] at law or in equity for the revocation of any contract” under FAA §2. Moreover, they argue that even if we construe the *Discover Bank* rule as a prohibition on collective-action waivers rather than simply an application of unconscionability, the rule would still be applicable to all dispute-resolution contracts, since California prohibits waivers of class litigation as well. See *America Online, Inc. v. Superior Ct.*, 90 Cal. App. 4th 1, 17–18, 108 Cal. Rptr. 2d 699, 711–713 (2001).

[¶14] When state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA. *Preston v. Ferrer*, 552 U. S. 346, 353 (2008). But the inquiry becomes more complex when a doctrine normally thought to be generally applicable, such as duress or, as relevant here, unconscionability, is alleged to have been applied in a fashion that disfavors arbitration. In *Perry v. Thomas*, 482 U. S. 483 (1987), for example, we noted that the FAA’s preemptive effect might extend even to grounds traditionally thought to exist “‘at law or in equity for the revocation of any contract.’” *Id.*, at 492, n. 9 (emphasis deleted). We said that a court may not “rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what . . . the state legislature cannot.” *Id.*, at 493, n. 9.

[¶15] An obvious illustration of this point would be a case finding unconscionable or unenforceable as against public policy consumer arbitration agreements that fail to provide for judicially monitored discovery. The rationalizations for such a holding are neither

difficult to imagine nor different in kind from those articulated in *Discover Bank*. A court might reason that no consumer would knowingly waive his right to full discovery, as this would enable companies to hide their wrongdoing. Or the court might simply say that such agreements are exculpatory—restricting discovery would be of greater benefit to the company than the consumer, since the former is more likely to be sued than to sue. See *Discover Bank*, *supra*, at 161, 113 P. 3d, at 1109 (arguing that class waivers are similarly one-sided). And, the reasoning would continue, because such a rule applies the general principle of unconscionability or public-policy disapproval of exculpatory agreements, it is applicable to “any” contract and thus preserved by §2 of the FAA. In practice, of course, the rule would have a disproportionate impact on arbitration agreements; but it would presumably apply to contracts purporting to restrict discovery in litigation as well.

[¶16] Other examples are easy to imagine. The same argument might apply to a rule classifying as unconscionable arbitration agreements that fail to abide by the Federal Rules of Evidence, or that disallow an ultimate disposition by a jury (perhaps termed “a panel of twelve lay arbitrators” to help avoid preemption). Such examples are not fanciful, since the judicial hostility towards arbitration that prompted the FAA had manifested itself in “a great variety” of “devices and formulas” declaring arbitration against public policy. *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F. 2d 402, 406 (CA2 1959). And although these statistics are not definitive, it is worth noting that California’s courts have been more likely to hold contracts to arbitrate unconscionable than other contracts. * * * *

[¶17] The *Concepcions* suggest that all this is just a parade of horrors, and no genuine worry. “Rules aimed at destroying arbitration” or “demanding procedures incompatible with arbitration,” they concede, “would be preempted by the FAA because they cannot sensibly be reconciled with Section 2.” Brief for Respondents 32. The “grounds” available under §2’s saving clause, they admit, “should not be construed to include a State’s mere preference for procedures that are incompatible with arbitration and ‘would wholly eviscerate arbitration agreements.’” *Id.*, at 33 (quoting *Carter v. SSC Odin Operating Co., LLC*, 237 Ill. 2d 30, 50, 927 N. E. 2d 1207, 1220 (2010)).

[¶18] We largely agree. Although §2’s saving clause preserves generally applicable contract defenses, nothing in it suggests an intent to preserve state-law rules that stand as an obstacle to the accomplishment of the FAA’s objectives. Cf. *Geier v. American Honda Motor Co.*, 529 U. S. 861, 872 (2000); *Crosby v. National Foreign Trade Council*, 530 U. S. 363, 372–373 (2000). As we have said, a federal statute’s saving clause “‘cannot in reason be construed as [allowing] a common law right, the continued existence of which would be absolutely inconsistent with the provisions of the act. In other words, the act cannot be held to destroy itself.’” *American Telephone & Telegraph Co. v. Central Office Telephone, Inc.*, 524 U. S. 214, 227–228 (1998) (quoting *Texas & Pacific R. Co. v. Abilene Cotton Oil Co.*, 204 U. S. 426, 446 (1907)).

[¶19] We differ with the *Concepcions* only in the application of this analysis to the matter before us. We do not agree that rules requiring judicially monitored discovery or adherence

to the Federal Rules of Evidence are “a far cry from this case.” Brief for Respondents 32. The overarching purpose of the FAA, evident in the text of §§2, 3, and 4, is to ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings. Requiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA.

B

[¶20] The “principal purpose” of the FAA is to “ensur[e] that private arbitration agreements are enforced according to their terms.” *Volt*, 489 U. S., at 478; see also *Stolt-Nielsen S. A. v. AnimalFeeds Int’l Corp.*, 559 U. S. ___, ___ (2010) (slip op., at 17). This purpose is readily apparent from the FAA’s text. Section 2 makes arbitration agreements “valid, irrevocable, and enforceable” as written (subject, of course, to the saving clause); §3 requires courts to stay litigation of arbitral claims pending arbitration of those claims “in accordance with the terms of the agreement”; and §4 requires courts to compel arbitration “in accordance with the terms of the agreement” upon the motion of either party to the agreement (assuming that the “making of the arbitration agreement or the failure . . . to perform the same” is not at issue). In light of these provisions, we have held that parties may agree to limit the issues subject to arbitration, *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U. S. 614, 628 (1985), to arbitrate according to specific rules, *Volt*, *supra*, at 479, and to limit with whom a party will arbitrate its disputes, *Stolt-Nielsen*, *supra*, at ___ (slip op., at 19).

[¶21] The point of affording parties discretion in designing arbitration processes is to allow for efficient, streamlined procedures tailored to the type of dispute. It can be specified, for example, that the decisionmaker be a specialist in the relevant field, or that proceedings be kept confidential to protect trade secrets. And the informality of arbitral proceedings is itself desirable, reducing the cost and increasing the speed of dispute resolution. *14 Penn Plaza LLC v. Pyett*, 556 U. S. ___, ___ (2009) (slip op., at 20); *Mitsubishi Motors Corp.*, *supra*, at 628.

[¶22] The dissent quotes *Dean Witter Reynolds Inc. v. Byrd*, 470 U. S. 213, 219 (1985), as “‘reject[ing] the suggestion that the overriding goal of the Arbitration Act was to promote the expeditious resolution of claims.’” *Post*, at 4 (opinion of BREYER, J.). That is greatly misleading. After saying (accurately enough) that “the overriding goal of the Arbitration Act was [not] to promote the expeditious resolution of claims,” but to “ensure judicial enforcement of privately made agreements to arbitrate,” 470 U. S., at 219, *Dean Witter* went on to explain: “This is not to say that Congress was blind to the potential benefit of the legislation for expedited resolution of disputes. Far from it” *Id.*, at 220. It then quotes a House Report saying that “the costliness and delays of litigation . . . can be largely eliminated by agreements for arbitration.” *Ibid.* (quoting H. R. Rep. No. 96, 68th Cong., 1st Sess., 2 (1924)). The concluding paragraph of this part of its discussion begins as follows:

“We therefore are not persuaded by the argument that the conflict between two goals of the Arbitration Act—enforcement of private agreements and encouragement of efficient and speedy dispute resolution—must be resolved in favor of the latter in order to realize the intent of the drafters.” 470 U. S., at 221.

In the present case, of course, those “two goals” do not conflict—and it is the dissent’s view that would frustrate both of them.

[¶23] Contrary to the dissent’s view, our cases place it beyond dispute that the FAA was designed to promote arbitration. They have repeatedly described the Act as “embod[ying] [a] national policy favoring arbitration,” *Buckeye Check Cashing*, 546 U. S., at 443, and “a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary,” *Moses H. Cone*, 460 U. S., at 24; see also *Hall Street Assocs.*, 552 U. S., at 581. * * * * Thus, in *Preston v. Ferrer*, holding preempted a state-law rule requiring exhaustion of administrative remedies before arbitration, we said: “A prime objective of an agreement to arbitrate is to achieve ‘streamlined proceedings and expeditious results,’” which objective would be “frustrated” by requiring a dispute to be heard by an agency first. 552 U. S., at 357–358. That rule, we said, would “at the least, hinder speedy resolution of the controversy.” *Id.*, at 358.

[¶24] California’s Discover Bank rule similarly interferes with arbitration. Although the rule does not require classwide arbitration, it allows any party to a consumer contract to demand it *ex post*. The rule is limited to adhesion contracts, *Discover Bank*, 36 Cal. 4th, at 162–163, 113 P. 3d, at 1110, but the times in which consumer contracts were anything other than adhesive are long past. *Carbajal v. H&R Block Tax Servs., Inc.*, 372 F. 3d 903, 906 (CA7 2004); see also *Hill v. Gateway 2000, Inc.*, 105 F. 3d 1147, 1149 (CA7 1997). The rule also requires that damages be predictably small, and that the consumer allege a scheme to cheat consumers. *Discover Bank*, *supra*, at 162–163, 113 P. 3d, at 1110. The former requirement, however, is toothless and malleable (the Ninth Circuit has held that damages of \$4,000 are sufficiently small, see *Oestreicher v. Alienware Corp.*, 322 Fed. Appx. 489, 492 (2009) (unpublished)), and the latter has no limiting effect, as all that is required is an allegation. Consumers remain free to bring and resolve their disputes on a bilateral basis under *Discover Bank*, and some may well do so; but there is little incentive for lawyers to arbitrate on behalf of individuals when they may do so for a class and reap far higher fees in the process. And faced with inevitable class arbitration, companies would have less incentive to continue resolving potentially duplicative claims on an individual basis.

[¶25] Although we have had little occasion to examine classwide arbitration, our decision in *Stolt-Nielsen* is instructive. In that case we held that an arbitration panel exceeded its power under §10(a)(4) of the FAA by imposing class procedures based on policy judgments rather than the arbitration agreement itself or some background principle of contract law that would affect its interpretation. 559 U. S., at ____ (slip op., at 20–23). We then held that the agreement at issue, which was silent on the question of class procedures, could not be interpreted to allow them because the “changes brought about by the shift

from bilateral arbitration to class-action arbitration” are “fundamental.” *Id.*, at ____ (slip op., at 22). This is obvious as a structural matter: Classwide arbitration includes absent parties, necessitating additional and different procedures and involving higher stakes. Confidentiality becomes more difficult. And while it is theoretically possible to select an arbitrator with some expertise relevant to the class-certification question, arbitrators are not generally knowledgeable in the often-dominant procedural aspects of certification, such as the protection of absent parties. The conclusion follows that class arbitration, to the extent it is manufactured by Discover Bank rather than consensual, is inconsistent with the FAA.

* * * *

[¶26] [The Majority reasoned that changes from bilateral to class-action are fundamental because class-action arbitration slows the arbitration process considerably, sacrifices arbitration’s informality, and “increases risks to defendants.” Along the way, the Court observed,

The dissent claims that class arbitration should be compared to class litigation, not bilateral arbitration. *Post*, at 6–7. Whether arbitrating a class is more desirable than litigating one, however, is not relevant. A State cannot defend a rule requiring arbitration-by-jury by saying that parties will still prefer it to trial-by-jury.

For a class-action money judgment to bind absentees in litigation, class representatives must at all times adequately represent absent class members, and absent members must be afforded notice, an opportunity to be heard, and a right to opt out of the class. *Phillips Petroleum Co. v. Shutts*, 472 U. S. 797, 811–812 (1985). At least this amount of process would presumably be required for absent parties to be bound by the results of arbitration.]

[¶27] We find it unlikely that in passing the FAA Congress meant to leave the disposition of these procedural requirements to an arbitrator. Indeed, class arbitration was not even envisioned by Congress when it passed the FAA in 1925; as the California Supreme Court admitted in *Discover Bank*, class arbitration is a “relatively recent development.” 36 Cal. 4th, at 163, 113 P. 3d, at 1110. And it is at the very least odd to think that an arbitrator would be entrusted with ensuring that third parties’ due process rights are satisfied.

[¶28] Third, class arbitration greatly increases risks to defendants. Informal procedures do of course have a cost: The absence of multilayered review makes it more likely that errors will go uncorrected. Defendants are willing to accept the costs of these errors in arbitration, since their impact is limited to the size of individual disputes, and presumably outweighed by savings from avoiding the courts. But when damages allegedly owed to tens of thousands of potential claimants are aggregated and decided at once, the risk of an error will often become unacceptable.

[¶29] Faced with even a small chance of a devastating loss, defendants will be pressured into settling questionable claims. Other courts have noted the risk of “in *terrorem*”

settlements that class actions entail, see, e.g., *Kohen v. Pacific Inv. Management Co. LLC*, 571 F. 3d 672, 677–678 (CA7 2009), and class arbitration would be no different.

[¶30] Arbitration is poorly suited to the higher stakes of class litigation. In litigation, a defendant may appeal a certification decision on an interlocutory basis and, if unsuccessful, may appeal from a final judgment as well. Questions of law are reviewed *de novo* and questions of fact for clear error. In contrast, 9 U. S. C. §10 allows a court to vacate an arbitral award only where the award “was procured by corruption, fraud, or undue means”; “there was evident partiality or corruption in the arbitrators”; “the arbitrators were guilty of misconduct in refusing to postpone the hearing . . . or in refusing to hear evidence pertinent and material to the controversy[,] or of any other misbehavior by which the rights of any party have been prejudiced”; or if the “arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award . . . was not made.” The AAA rules do authorize judicial review of certification decisions, but this review is unlikely to have much effect given these limitations; review under §10 focuses on misconduct rather than mistake. And parties may not contractually expand the grounds or nature of judicial review. *Hall Street Assocs.*, 552 U. S., at 578. We find it hard to believe that defendants would bet the company with no effective means of review, and even harder to believe that Congress would have intended to allow state courts to force such a decision.

[¶31] The Concepcions contend that because parties may and sometimes do agree to aggregation, class procedures are not necessarily incompatible with arbitration. But the same could be said about procedures that the Concepcions admit States may not superimpose on arbitration: Parties could agree to arbitrate pursuant to the Federal Rules of Civil Procedure, or pursuant to a discovery process rivaling that in litigation. Arbitration is a matter of contract, and the FAA requires courts to honor parties’ expectations. *Rent-A-Center, West*, 561 U. S., at ____ (slip op., at 3). But what the parties in the aforementioned examples would have agreed to is not arbitration as envisioned by the FAA, lacks its benefits, and therefore may not be required by state law.

[¶32] The dissent claims that class proceedings are necessary to prosecute small-dollar claims that might otherwise slip through the legal system. See post, at 9. But States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons. Moreover, the claim here was most unlikely to go unresolved. As noted earlier, the arbitration agreement provides that AT&T will pay claimants a minimum of \$7,500 and twice their attorney’s fees if they obtain an arbitration award greater than AT&T’s last settlement offer. The District Court found this scheme sufficient to provide incentive for the individual prosecution of meritorious claims that are not immediately settled, and the Ninth Circuit admitted that aggrieved customers who filed claims would be “essentially guarantee[d]” to be made whole, 584 F. 3d, at 856, n. 9. Indeed, the District Court concluded that the Concepcions were better off under their arbitration agreement with AT&T than they would have been as participants in a class action, which “could take months, if not years, and which may merely yield an opportunity to submit a claim for recovery of a small percentage of a few dollars.” *Laster*, 2008 WL 5216255, at *12.

* * *

[¶33] Because it “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,” *Hines v. Davidowitz*, 312 U. S. 52, 67 (1941), California’s Discover Bank rule is preempted by the FAA. The judgment of the Ninth Circuit is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

[Justice Thomas concurred but explained that he grounded his decision not in the purpose of the FAA but in its text.]

JUSTICE BREYER, with whom JUSTICE GINSBURG, JUSTICE SOTOMAYOR, and JUSTICE KAGAN join, dissenting.

[¶1] The Federal Arbitration Act says that an arbitration agreement “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” 9 U. S. C. §2 (emphasis added). California law sets forth certain circumstances in which “class action waivers” in any contract are unenforceable. In my view, this rule of state law is consistent with the federal Act’s language and primary objective. It does not “stan[d] as an obstacle” to the Act’s “accomplishment and execution.” *Hines v. Davidowitz*, 312 U. S. 52, 67 (1941). And the Court is wrong to hold that the federal Act pre-empts the rule of state law.

I

[¶2] The California law in question consists of an authoritative state-court interpretation of two provisions of the California Civil Code. The first provision makes unlawful all contracts “which have for their object, directly or indirectly, to exempt anyone from responsibility for his own . . . violation of law.” Cal. Civ. Code Ann. §1668 (West 1985). The second provision authorizes courts to “limit the application of any unconscionable clause” in a contract so “as to avoid any unconscionable result.” §1670.5(a).

[¶3] The specific rule of state law in question consists of the California Supreme Court’s application of these principles to hold that “some” (but not “all”) “class action waivers” in consumer contracts are exculpatory and unconscionable under California “law.” *Discover Bank v. Superior Ct.*, 36 Cal. 4th 148, 160, 162, 113 P. 3d 1100, 1108, 1110 (2005). In particular, in *Discover Bank* the California Supreme Court stated that, when a class-action waiver

“is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of

money, then . . . the waiver becomes in practice the exemption of the party ‘from responsibility for [its] own fraud, or willful injury to the person or property of another.’” *Id.*, at 162–163, 113 P. 3d, at 1110.

In such a circumstance, the “waivers are unconscionable under California law and should not be enforced.” *Id.*, at 163, 113 P. 3d, at 1110.

[¶4] The Discover Bank rule does not create a “blanket policy in California against class action waivers in the consumer context.” *Provencher v. Dell, Inc.*, 409 F. Supp. 2d 1196, 1201 (CD Cal. 2006). Instead, it represents the “application of a more general [unconscionability] principle.” *Gentry v. Superior Ct.*, 42 Cal. 4th 443, 457, 165 P. 3d 556, 564 (2007). Courts applying California law have enforced class-action waivers where they satisfy general unconscionability standards. [String cite omitted.] And even when they fail, the parties remain free to devise other dispute mechanisms, including informal mechanisms, that, in context, will not prove unconscionable. See *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U. S. 468, 479 (1989). * * * *

III

[¶5] The majority’s contrary view (that Discover Bank stands as an “obstacle” to the accomplishment of the federal law’s objective, *ante*, at 9–18) rests primarily upon its claims that the Discover Bank rule increases the complexity of arbitration procedures, thereby discouraging parties from entering into arbitration agreements, and to that extent discriminating in practice against arbitration. These claims are not well founded.

[¶6] For one thing, a state rule of law that would sometimes set aside as unconscionable a contract term that forbids class arbitration is not (as the majority claims) like a rule that would require “ultimate disposition by a jury” or “judicially monitored discovery” or use of “the Federal Rules of Evidence.” *Ante*, at 8, 9. Unlike the majority’s examples, class arbitration is consistent with the use of arbitration. It is a form of arbitration that is well known in California and followed elsewhere. * * * * Indeed, the AAA has told us that it has found class arbitration to be “a fair, balanced, and efficient means of resolving class disputes.” Brief for AAA as Amicus Curiae in *Stolt-Nielsen S. A. v. AnimalFeeds Int’l Corp.*, O. T. 2009, No. 08–1198, p. 25 (hereinafter AAA Amicus Brief).

[¶7] And unlike the majority’s examples, the Discover Bank rule imposes equivalent limitations on litigation; hence it cannot fairly be characterized as a targeted attack on arbitration.

[¶8] Where does the majority get its contrary idea—that individual, rather than class, arbitration is a “fundamental attribut[e]” of arbitration? *Ante*, at 9. The majority does not explain. And it is unlikely to be able to trace its present view to the history of the arbitration statute itself. When Congress enacted the Act, arbitration procedures had not yet been fully developed. * * * *

[¶9] Further, even though contract defenses, e.g., duress and unconscionability, slow down the dispute resolution process, federal arbitration law normally leaves such matters to the States. *Rent-A-Center, West, Inc. v. Jackson*, 561 U. S. ___, ___ (2010) (slip op., at 4) (arbitration agreements “may be invalidated by ‘generally applicable contract defenses’” (quoting *Doctor’s Associates, Inc. v. Casarotto*, 517 U. S. 681, 687 (1996))). A provision in a contract of adhesion (for example, requiring a consumer to decide very quickly whether to pursue a claim) might increase the speed and efficiency of arbitrating a dispute, but the State can forbid it. See, e.g., *Hayes v. Oakridge Home*, 122 Ohio St. 3d 63, 67, 2009–Ohio–2054, ¶19, 908 N. E. 2d 408, 412 (“Unconscionability is a ground for revocation of an arbitration agreement”); *In re Poly-America, L. P.*, 262 S. W. 3d 337, 348 (Tex. 2008) (“Unconscionable contracts, however—whether relating to arbitration or not—are unenforceable under Texas law”). The Discover Bank rule amounts to a variation on this theme. California is free to define unconscionability as it sees fit, and its common law is of no federal concern so long as the State does not adopt a special rule that disfavors arbitration. Cf. *Doctor’s Associates*, supra, at 687. See also ante, at 4, n. (THOMAS, J., concurring) (suggesting that, under certain circumstances, California might remain free to apply its unconscionability doctrine). * * * *

[¶10] What rational lawyer would have signed on to represent the Concepcions in litigation for the possibility of fees stemming from a \$30.22 claim? See, e.g., *Carnegie v. Household Int’l, Inc.*, 376 F. 3d 656, 661 (CA7 2004) (“The realistic alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for \$30”). In California’s perfectly rational view, nonclass arbitration over such sums will also sometimes have the effect of depriving claimants of their claims (say, for example, where claiming the \$30.22 were to involve filling out many forms that require technical legal knowledge or waiting at great length while a call is placed on hold). Discover Bank sets forth circumstances in which the California courts believe that the terms of consumer contracts can be manipulated to insulate an agreement’s author from liability for its own frauds by “deliberately cheat[ing] large numbers of consumers out of individually small sums of money.” 36 Cal. 4th, at 162–163, 113 P. 3d, at 1110. Why is this kind of decision—weighing the pros and cons of all class proceedings alike—not California’s to make? * * * *

IV

[¶11] By using the words “save upon such grounds as exist at law or in equity for the revocation of any contract,” Congress retained for the States an important role incident to agreements to arbitrate. 9 U. S. C. §2. Through those words Congress reiterated a basic federal idea that has long informed the nature of this Nation’s laws. We have often expressed this idea in opinions that set forth presumptions. See, e.g., *Medtronic, Inc. v. Lohr*, 518 U. S. 470, 485 (1996) (“[B]ecause the States are independent sovereigns in our federal system, we have long presumed that Congress does not cavalierly pre-empt state-law causes of action”). But federalism is as much a question of deeds as words. It often takes the form of a concrete decision by this Court that respects the legitimacy of a State’s action in an individual case. Here, recognition of that federalist ideal, embodied in specific language in this particular statute, should lead us to uphold California’s law, not to strike it down. We do not honor federalist principles in their breach.

With respect, I dissent.

Questions:

1. Would the majority require enforcement of a clause in a consumer contract that gave the consumer a choice whether to proceed on the basis of bilateral arbitration or class-action arbitration, and specified procedures intended to satisfy due process concerns of non-participating plaintiff class members?
2. Would the majority uphold a decision by a state court that a particular arbitration clause is unconscionable, say in the following case? An 86-year-old man with a 6th-grade education living alone on (i) social security and (ii) profits from cash-only work fixing lawn-mower engines and without knowledge of what is happening in the world or even in his own neighborhood signs a deal to sell his only real asset, a real property parcel of 10 acres, for 100% of its value as land but only 10% of its market value in mineral rights, to a mineral rights speculator who knew that drilling would promptly commence, but then the speculator comes back three days later and tells the man he also wants him to sign this other page, which he says specifies the “court” in which they would resolve any disputes (but in fact this is a three-page, 12,000-word arbitration agreement to arbitrate any dispute in Paris before an arbitration panel of the International Board of Mineral Speculation, which, in highly convoluted language and very small print, requires an up-front, non-refundable fee of \$15,000 and allows the speculator to choose all of the arbitrators, who will arbitrate according to the trade practices of the Int’l Board of Mineral Speculation, none of which are written).
3. Error in arbitration is not fixable by an appeal afterward to real judges, as the Court said. Yet a quite large percentage of disputes are resolved today by arbitration. Does this have ramifications for the rule of law? If you as a consumer object to having disputes resolved

by arbitrators rather than courts, what can you do about it?

4. If consumers do not like arbitration, how can sellers of goods and services insist on it? Why isn't refusal to insist on arbitration a point of pride with sellers? Can you think of any arguments for arbitration from a consumer's perspective?

F. Remedies in UCC Article Two

1. Buyer's Damages

Uniform Commercial Code §§ 1-305, 2-711, 2-712, 2-713, 2-714, 2-715, 2-716

To some extent, these statutes embody the damage rules adopted by the common law. In important ways, however, the language of some of the statutes mandates that courts depart from common law rules. Section 2-711 is an organizing statute, saying what rules should apply when the buyer does not receive and retain goods from the seller because of the seller's breach. Section 2-714 applies when the buyer receives and retains good from the seller that do not conform to the contract or that breach a warranty. Section 2-715 gives some definitions.

Test your basic understanding of which rule applies by answering the following hypothetical questions:

a) Alpha received an order from Beta for widgets that Alpha manufactures and sells. Beta requested 100 widgets within 30 days, FOB Beta's plant. Beta planned to incorporate the widgets into microwave ovens Beta makes and sells. Alpha sent a message to Beta acknowledging receipt of the order and promised to deliver the widgets within 30 days, as requested. Forty days passed, and Beta received nothing; when asked, Alpha claimed it would not be able to deliver for another 15 days. After studying the market to find an acceptable substitute, Beta bought 100 widgets from Gamma at \$10 more per widget than Beta was going to pay Alpha. Under which damages rule should Beta proceed against Alpha? What damages will Alpha owe Beta?

b) Iota Inc. ordered 300 widgets from Kappa Corp., FOB Iota's offices. When they arrived at Iota's plant, Iota found they were partly unassembled and were each missing a thurquack. Iota needed to manufacture its telephone systems, in which the widgets would be installed, however. Iota immediately notified Kappa of the problem, but, because of its time deadline, rather than send the widgets back to Kappa, Iota had ten employees spend two days finishing their assembly, which included installing substitute thurquacks that Iota found in its storage. Less the thurquacks and partly unassembled, each Kappa widget was worth \$10 less than it would have been if complete. Now Iota would like to recover something for

Kappa's breach. Under which damages rule should Iota proceed against Kappa? What damages will Kappa owe?

c) Delta sent an order for 200 widgets to Zeta Corp, for delivery within 30 days, FOB Delta's place of business. Zeta sent an acknowledgement of the order and promised to deliver within 30 days. Twenty-nine days later, Delta received 200 widgets from Zeta, but none of them were as ordered. Eighty of them were the wrong model, another 80 were incorrectly made, and all the rest, forty, were damaged in shipping. Delta, after inspecting the goods, refused to sign for them, leaving them with the shipper. Delta immediately sent a message to Zeta saying it was rejecting the goods. Delta had intended to incorporate the widgets into wireless routers Delta was building. In the meantime, the market price of the widgets Delta ordered increased from \$80 at the time of order to \$90 per widget at the time of delivery. Now Delta's plans have changed, and it has re-designed its routers not to use widgets, but the re-design cost money that Delta would like to re-coup in a suit against Zeta. Under which damages rule should Delta proceed against Zeta? What damages will Zeta owe Delta?

One of the drawbacks of working from legal rules that are more particular or specific than those of the common law is that situations arise that seem to have been outside the particular rule's purpose. When that occurs, should the court fall back on § 1-305, the more general principle, or stick with the more particular rule? What arguments would you make in the next three problems? Your teacher will tell you how they came out, or at least how they should be analyzed, when you come to class.

PROBLEM 12: California lettuce grower and distributor KGM Harvesting Co. (KGM) contracted in 1989 to deliver loads of lettuce weekly to Ohio, for Fresh Network (FN). A load consists of 40 bins, each of which weighs between 1,000 and 1,200 pounds. By 1991, the agreement of KGM and FN required KGM to deliver 14 loads per week to FN. FN would pay 9 cents per pound for the lettuce. FN sold all the lettuce to Castellini Company, a lettuce broker, on a cost-plus basis, meaning that Castellini would pay FN whatever FN paid for the lettuce, plus some more as profit. Castellini resold the lettuce to Club Chef, which also paid cost-plus. Club Chef shredded the lettuce for the fast food industry (Burger King, Taco Bell, and Pizza Hut). Rather than re-deliver the lettuce through this chain of middle-people, KGM simply delivered it to Club Chef.

In May and June 1991, the market price of lettuce rose dramatically, and KGM refused to deliver at the contract price. It sold the lettuce to others at a large profit (between \$800,000 and \$1,100,000). FN, angry at KGM, refused to pay KGM \$233,000 that it owed KGM for prior deliveries. FN then went to the open market and covered lettuce for Castellini. FN paid \$650,960.22 above the contract price by buying it on the open market to cover its contract with Castellini. However, Castellini paid all of FN's extra expense except \$70,000. Castellini passed on its extra costs to Club Chef. Club Chef passed on part of the extra costs to the fast food chains.

In July 1991, KGM and FN sued each other. KGM sued for the balance due on prior deliveries. FN sued KGM for breach, for failure to deliver. At trial, both parties

stipulated that KGM was owed for the prior deliveries. The jury then determined that FN was entitled to the cost of cover, which was \$650,960.22, a lot of lettuce! KGM now appeals to you.

1) KGM's first argument is that FN should only get the benefit of its bargain. What does this require in terms of FN's damages? What statutory authority supports KGM's argument?

2) Usually, cost of cover damages under §2-712 would approximate the benefit of the bargain. Does it in this case? Why or why not? Which remedy, benefit of the bargain or cost of cover, best hews to the parties' bargain?

3) What is the role of mitigation in all this? If we follow § 2-712, does FN not receive a windfall?

This problem is based on *KGM Harvesting Co. v. Fresh Network*, 42 Cal. Rptr. 286 (Cal. App. 1995).

PROBLEM 13: Denis Tongish contracted to sell to Decatur Co-op 116.8 acres worth of sunflower seed crop at \$13 per 100wt. for large seeds and \$8 per 100wt. for small seeds. The crop was to be delivered in increments of one-third by December 31, 1988, March 31, 1989, and May 31, 1989. The Co-op had a contract to sell the seeds to Bambino Bean & Seed for the same price it paid farmers plus a \$.55 100wt. handling fee. The Co-op's only profit was the handling fee.

In October and November 1988, Tongish delivered seeds to the Co-op. In January, a dispute arose over dockage charges. Tongish's seeds were of higher quality than other producers, yet the Co-op mixed them in with other producers' to Tongish's detriment. The parties worked out a compromise of this problem in which the Co-op paid Tongish a bit extra to make up for their own lower costs. Then the market price of sunflower seeds jumped by January 1989 to double the contract price. Tongish notified the Co-op that he would not deliver any more. In May 1989, Tongish sold and delivered 82,820 lbs. of seeds to Thomas for \$20 per 100wt. Tongish was to receive \$14,714.89 for these seeds, which was \$5,153.13 more than the Co-op would have paid.

Thomas paid Tongish half what he owed him. Tongish sued Thomas for the balance, but Thomas put the balance of \$7,359.61 into court and was dismissed from the action. In the meantime, the Co-op had intervened, seeking damages for Tongish's breach. In fact, the Co-op had lost, because of its contract with Bambino, \$455.51 because of Tongish's failure to deliver. The trial court held that Tongish had breached.

1) What do §§ 2-711 and 2-713 suggest should be the damages?

2) What does § 1-305 suggest should be the damages? What would you do?

3) You have probably noticed that this problem looks like the last problem, somewhat. Perhaps you saw some bargain-centered sense in 2-712, even in the last problem. How is 2-713 even more removed from that bargain?

4) If Tongish can sell his seeds to someone else who values them more highly than the promisee and still make sure his promisee is no worse off (say, by paying them \$455.51), then hasn't Tongish taken the most efficient course of action by breaching?

5) What would be the point of choosing to follow § 2-713 in a case in which the buyer would be awarded more than its possible profits? Why not force parties to cover?

This problem is based on *Tongish v. Thomas*, 840 P.2d 471 (Kan. 1992).

PROBLEM 14: Fertico Belgium S.A. (Fertico), an international fertilizer trader, contracted to buy from Phosphate Chemicals Export Association, Inc. (Phosphate) two shipments of fertilizer for delivery in Antwerp, Belgium. The first shipment, 15,000 tons, was to be delivered by November 20, 1978, and the second of 20,000 tons by November 30. Phosphate knew that Fertico required delivery on these dates so that the fertilizer could be bagged and shipped by boat to Basra, Iraq, in satisfaction of a second contract that Fertico had with Altawreed, Iraq's agricultural ministry. Fertico secured a letter of credit for the first shipment. A letter of credit is a representation from a bank that it will guarantee payment to a seller as long as the seller meets certain specific conditions, including, usually, the presentation of documents that represent delivery of goods.

Phosphate then told Fertico it would not deliver the first shipment until December 4. Fertico advised Phosphate on November 13 that this was a material breach, and Fertico canceled the second shipment, which would be later still.

Phosphate drew on Fertico's letter of credit on November 17 to obtain payment for the first shipment. The first shipment did not arrive until December 17. By then, because Fertico had already paid for it through the letter of credit, Fertico kept that shipment. "We had no other choice," Fertico's president explained.

Because Fertico was not going to have enough time to get the fertilizer from its port in Antwerp to Basra to meet its obligations, and because it was now not going to have enough fertilizer, on November 13 Fertico made a deal with Unifert, a Lebanese company, for 35,000 tons of fertilizer, and negotiated a change in its deal with Altawreed so that it could deliver overland to Iraq instead of by boat through the port of Basra. In fact, Altawreed paid Fertico another \$20.50 per ton for overland delivery. Fertico fulfilled its obligations to Altawreed with the fertilizer from Unifert. The Unifert fertilizer cost Fertico \$4,725,000, as opposed to the \$4,025,000 that Fertico was going to pay Phosphate.

Fertico sold the leftover 15,000 tons to Janssens in March 1979, after storing it for three months, at a \$454,000 profit based on what it had paid Phosphate.

In 1981, Fertico sued Phosphate seeking \$1.25 million in damages.

1) What does § 2-712 suggest damages should be?

2) Are the additional costs of transporting the fertilizer overland (\$20.50 per ton) incidental or consequential damages?

3) Must Fertico subtract from its damages the profits it made on the re-sale of the 15,000 tons of fertilizer to Janssens? Does § 1-305 have an effect here? Would a sale to Janssens have occurred if Unifert had not breached? We have a name for a party like Fertico; we call them a “lost volume seller,” which means that they have access to functionally limitless quantities of the thing they sell so that there is no causal relationship between the loss of one sale and the next sale occurring. For a lost volume seller, losing a sale does not make a second sale possible; the second sale would have happened anyway, and absent breach the seller would have had two sales.

When you answer this question (3), please be careful how you read the phrase “less expenses saved in consequence of the seller’s breach”; it actually plays no role in the outcome. That language is in fact limited to the kinds of things § 2-715(1) calls “expenses.”

This problem is based on *Fertico Belgium S.A. v. Phosphate Chemicals Export Association, Inc.*, 510 N.E. 334 (N.Y. 1987).

TROXLER ELECTRONICS LABORATORIES, INC. v. SOLITRON DEVICES, INC.
4th Cir. U.S. Ct. App. (1984), 722 F.2d 81

RUSSELL, C.J.:

[¶1] This is a breach of contract action. The plaintiff Troxler Electronic Laboratories, Inc. (hereafter "Troxler") entered into a contract with Solitron Devices, Inc. (hereafter "Solitron") whereby Solitron agreed to manufacture and sell to Troxler certain quantities of three custom-made micro-electronic components to be used by Troxler in the production of a new and improved Series of nuclear gauges (the "3400 Series") for the measurement of the moisture content and density of soil for construction and agricultural purposes. At the time, Troxler was the leader in the manufacture and sale of such gauges, having approximately 75% of the world market. This new Series was intended to replace an existing Series (the "2400 Series") and was thought to involve lower costs of production for Troxler as manufacturer and lower costs of operations and enlarged use for the purchaser or user. Because of its improvements, the 3400 Series was expected to command a higher price and to provide a substantially greater profit for Troxler than the existing 2400 Series.

[¶2] A basic part of this new Series was a type of integrated circuit known as a CMOS device or chip. While such chips were standard items on the electronics market, their combination in the new Series planned by Troxler was unique. Troxler therefore prepared "logic drawings" of the specific device in the combination it required for its gauge and solicited bids therefor on a custom basis. Solitron responded with a quotation. Negotiations

began between Troxler and Solitron pursuant to that bid. There was testimony that in these negotiations Troxler advised Solitron of the purposes for which it sought the article, how the article was to be used, the need for prompt production of its new Series in order to secure a competitive advantage in the market through early introduction of the Series, and the economic benefits it hoped to achieve in the shift to the new Series. As a result of these negotiations, Troxler issued to Solitron its purchase order dated November 2, 1972, which was accepted by Solitron on November 9, 1972. The purchase order as accepted included specific dates for delivery of both prototypes and finished products. Solitron in its acceptance had lengthened the dates for delivery of both prototypes and the final product. Solitron made no other change in the order as submitted by Troxler.

[¶3] None of the delivery dates fixed by Solitron in its acceptance were met. The District Judge found that "[w]hen informed of Troxler's concerns over delays [in such deliveries], Solitron continually provided Troxler with expected dates of completion that were not only unduly optimistic, but probably knowingly and falsely so." During these periods of delay, Solitron also made of Troxler a request for a price increase of almost 100% in the purchase price of the articles to be delivered and Troxler contends that, in making such request, Solitron implied it would not make delivery in the absence of such increase. This request or demand was rejected by Troxler. Finally, in March 1975, Solitron made small partial deliveries of the articles purchased of it by Troxler; but, without further compliance it completely repudiated its contract in September, 1975 by announcing that it would no longer manufacture custom chips.

[¶4] When Solitron repudiated its contract, Troxler redesigned its new Series in order to secure substitute standard parts which had been developed and had become available during Solitron's long delay in performing its contract. Troxler then filed its action to recover for damages arising from Solitron's breach of its contract. The District Court, after a full evidentiary trial without a jury, found that Solitron had breached its contract of sale with Troxler, awarded recovery by Troxler for various items of damages it found Troxler had sustained as a result of such breach, but denied recovery by Troxler for lost profits as an item of damages. Solitron has appealed the finding of contract breach and, assuming there was a breach, it has challenged the grant of the several items of damages in favor of Troxler; Troxler has cross-appealed the denial of lost profits as an item of damages recoverable by it in this action. We affirm in part and reverse in part, and remand for additional findings.

[¶5] We address first the appeal of Solitron. We begin by noting that Solitron does not seriously contest the finding that it breached the contract. Thus, after conceding in its brief that it "did not meet the exact time requirements of the original purchase order," an act which it admits may be "considered a breach of the contract" by it, and while disclaiming any purpose on its part to "offer . . . excuses as to why the prototypes were not submitted to the Plaintiff on February 2, 1973," it argues that Troxler suffered no damages from such breach. In effect, Solitron's appeal is directed not at a finding of a breach of the contract on its part but at the various items of damages found by the District Court in favor of Troxler.

Unquestionably, the propriety of such allowances of damages present difficult, at times even complex, disputed factual issues. The District Judge, however, painstakingly analyzed the evidence, considered the evidence offered by both Troxler and Solitron, and resolved these disputed factual issues. We may have reached a different conclusion on the facts had we been the trier of first instance, but that is not our province. We can only reverse if the factual determinations by the District Judge lack substantial support in the record and are clearly erroneous. We find no such clear error and accordingly affirm those damages findings of the District Judge which are challenged on this appeal by Solitron.

[¶6] We turn now to Troxler's cross-appeal complaining of the denial of lost profits as an item of damages. In essence, Troxler's claim is that because of Solitron's breach of contract and the resulting twenty-month delay in introducing the 3400 Series gauges, Troxler lost the higher margin of profit which the more advanced 3400 Series enjoyed, due to lower production costs, over the existing 2400 Series. Once the 3400 Series finally came onto the market during 1975-76, the 2400 Series was phased out of production. Troxler contends that sales figures for the 3400 Series when actually introduced furnish a reliable means of calculating sales and profitability for those models had they been available during 1973-75 as originally planned. The District Court disallowed the calculations of lost profits under this formula, basing its denial on alternative grounds. It first found that Troxler had "failed to show its damages to a reasonable degree of certainty." However, it did not support this conclusory statement with any specific findings of fact. Rather, it declared alternatively that lost profits were not recoverable because "[t]here is no indication that Solitron agreed, at the time the contract was created, to accept liability for Troxler's lost profits," and it considered the attempt of Troxler to recover such lost profits to be an "attempt to modify the contract's requirements ex post facto." (Italics in the original)

[¶7] The parties seemingly agree that the right of Troxler to recover "lost profits" is controlled by the law of North Carolina. The recovery of lost profits under North Carolina law depends on whether such profits can qualify as "consequential damages" under N.C.Gen.Stat. Sec. 25-2-715(2)(a) (1965), which defines such damages as "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." The North Carolina Comment to such statute declares that "[t]his section generally restates prior North Carolina law," and observes that under North Carolina common law consequential damages "which are within the contemplation of the parties" were recoverable by the buyer. As the Comment suggests, North Carolina cases decided prior to the adoption of the Uniform Commercial Code adhered to the rule of *Hadley v. Baxendale*, 9 Exch. 341, 156 Eng.Rep. 145 (1854). See *Perkins v. Langdon*, 237 N.C. 159, 74 S.E.2d 634, 643-44 (1953).

[¶8] Two interpretations of *Hadley v. Baxendale* have, however, been advanced. The more restrictive "tacit agreement" test requires the parties to have contemplated specifically that consequential damages might result, and that the defendant have actually assumed the risk of those damages. The more recent trend in the cases, however, places upon the

defendant the risk of such consequential damages that "reasonable men in the position of the parties would have foreseen as a probable result of breach," without any requirement of actual consideration or assumption of such damages by the parties themselves. 5 A. Corbin, Contracts Sec. 1010 at 79 (1964). See J. White & R. Summers, Uniform Commercial Code 388-91 (2d ed. 1980). Prior to the enactment of the U.C.C. in North Carolina, in *Troitino v. Goodman*, 225 N.C. 406, 35 S.E.2d 277, 281-82 (1945), the North Carolina Supreme Court appears to have adopted this more recent trend in the application of Hadley by accepting the test as set forth in Section 330, Restatement of Contracts (1932), which allows damages for "those injuries that the defendant had reason to foresee as a probable result of his breach when the contract was made."

[¶9] If North Carolina courts have in effect adopted the rule as stated in Section 330, it is easy to deduce the North Carolina rule on lost profits. Comment a. to Sec. 330 declares unequivocally that the defendant need not "have had the resulting injury actually in contemplation or [have] promised either impliedly or expressly to pay therefor in case of breach" in order for lost profits to be recoverable. Comment c. follows by indicating that a seller usually has reason to foresee that the buyer will resell goods at a "reasonable profit," and that failure to deliver as agreed will deprive the buyer of that profit. Accordingly, there would seem to be no doubt which reading of *Hadley v. Baxendale* North Carolina intended to govern, assuming it was adopting the rule as stated in Sec. 330 of the Restatement of Contracts.

[¶10] North Carolina law under the U.C.C. follows the trend in the case law as illustrated by *Goodman*. In the U.C.C. Official Comment attached to N.C.Gen.Stat. Sec. 25-2-715, the drafters explicitly rejected the "tacit agreement" theory in favor of a reasonable foreseeability test, Comment 2, and stated that "[i]t is not necessary that there be a conscious acceptance of an insurer's liability on the seller's part." Comment 3. And this seems to have been the ruling of such North Carolina appellate courts as have had occasion to apply the Section. In *Rodd v. W.H. King Drug Co.*, 30 N.C.App. 564, 228 S.E.2d 35, 38 (1976), the court recognized that consequential damages for operating losses which a defendant "reasonably could have foreseen" are recoverable under Sec. 25-2-715. Our own prior interpretations of North Carolina law are in accord. See *Gurney Industries, Inc. v. St. Paul Fire & Marine Ins. Co.*, 467 F.2d 588, 598 (4th Cir.1972).

[¶11] Since the District Court's denial of damages for lost profits rested in part on the assumption that Solitron had to agree to assume that liability, we must reverse, and remand for determination of Solitron's consequential damages liability under the "reasonable foreseeability" test, which we believe to be the controlling North Carolina rule.

[¶12] If the District Court finds that Solitron should reasonably have foreseen that Troxler would suffer a loss of profits from its breach, it must further determine whether those damages were sufficiently specific to permit recovery. While the District Court held in the alternative that Troxler had "failed to show its damages to a reasonable degree of certainty," it offered, as we have already observed, no explanation for this bare conclusion, and we

can hardly determine whether the "clearly erroneous" rule should insulate this finding of fact without some insight into the District Court's reasoning. We decline to perform the task of calculating damages ourselves, as that factual issue is primarily the responsibility of the District Court, but we note that the U.C.C. Official Comment to N.C.Gen.Stat. Sec. 25-2-715 rejects any need for "mathematical precision," accepting that "[l]oss may be determined in any manner which is reasonable under the circumstances." Comment 4. See also *Republic National Life Insurance Company v. Red Lion Homes, Inc.*, 704 F.2d 484, 489 (10th Cir.1983); *Certain-Teed Prod. Corp. v. Goslee Roofing & S.M., Inc.*, 26 Md.App. 452, 339 A.2d 302, 317 (1975). Troxler's own calculations of lost profits may be exaggerated, but it does not follow that Troxler's lost profits, if any, are not to be calculated at all.

[¶13] Accordingly, we affirm the judgment in Solitron's appeal (No. 82-2078), and reverse on Troxler's cross-appeal (No. 82-2098), and remand for further proceedings consistent with this opinion.

Questions:

1. Two interpretations of *Hadley* exist. What is the difference between them?
2. Suppose a soda pop bottler negligently allowed mice to get into the bottles and sent ten bottles of mice in cola to a certain small store, one of two small stores operating in a small town. The public relations fiasco resulted in the store's bankruptcy. The mice were a breach of contract with the store. Can destruction of the store's reputation be included in damages?
3. How about the late delivery of hog cholera serum? Consequential damages for that?
4. How about the late delivery of musical play scenery?

PROBLEM 15: *Schroeder v. Barth, Incorporated*, 969 F.2d 421 (7th Cir. 1992), reports the following facts:

[¶1] Lester and Viola Schroeder, an elderly couple, wanted nothing more than a reliable, comfortable motor home to provide them with transportation and housing on their leisurely travels around the country. With that in mind, on March 13, 1981, they bought a 1981 Barth MCC Model 35 motor home from Motor Vacations Unlimited, of Elgin, Illinois, for \$146,705.00. The Schroeders took delivery of the vehicle in July 1981. It came with a manufacturer's one year limited warranty. Barely 2,600 miles and five months later, on December 3, 1981, Lester Schroeder wrote a letter to Charles Dolan of Motor Vacations Unlimited cataloguing sixty-one separate problems he had experienced with the motor home since taking delivery. Dolan sent a copy of the letter and list to Richard Bibler, Assistant to the President of Barth, Incorporated ("Barth"), the manufacturer. Bibler, on June 24,

1982, wrote to Schroeder to inform him that Barth would extend its warranty to January 27, 1983. The Schroeders continued to experience a multitude of problems with the motor home, however, well beyond the extended warranty date. Lester attempted to remedy some of the problems himself. On some occasions he sought the assistance of others, Barth included. But the motor home never operated to the Schroeders' satisfaction, so they gave up trying to get it repaired.

[¶2] On March 7, 1985, the Schroeders, citizens of Florida, filed a complaint against Barth, an Indiana corporation, in the United States District Court for the Northern District of Indiana. * * * [T]he complaint alleges breach of express and implied warranties, and breach of contract. On their breach of warranty claims, the Schroeders pray for judgment "in the amount of One Hundred Forty-Six Thousand Seven Hundred Five Dollars (\$146,705); reasonable attorneys' fees; interest from the date of payment; expenses reasonably incurred by the plaintiffs; costs of this action; and all other just and proper relief in the premises." Complaint, Record Document ("Rec. Doc.") No. 1, at 3 & 5. * * * *

The trial court found liability for breach of express warranty. On damages, the Schroeders were not always helpful to their own cause:

[¶3] The only further information the Schroeders provided the court regarding the amount in controversy was the affidavit of Lester, wherein he recounted many of the problems he had experienced with the motor home, and stated, "Since I took delivery of [the motor home] in July 1981, the 1981 Barth MCC Model 35 Motor Home has been worthless to me and to my wife; the motor home has had absolutely no value whatsoever." Affidavit of Lester J. Schroeder, Rec. Doc. No. 19, at 4. * * * *

[¶4] After the case was set for trial, the Schroeders moved for a continuance for additional time within which to locate an expert to support their theory of damages. The motion was granted. The Schroeders then hired Dr. Thomas A. Natiello to render an expert opinion as to the value of the motor home. Barth objected to Natiello on the grounds that he is a health care specialist with no experience or training in the valuation of motor homes, and renewed its motion to dismiss for lack of subject matter jurisdiction because the Schroeders failed to establish the \$50,000 jurisdictional amount. In reply, the Schroeders relied on both Natiello's valuation of the motor home and Lester's affidavit. In its Memorandum and Order of January 8, 1991, the court sustained Barth's objection to Natiello's testimony for lack of the expert qualifications necessary to state an opinion as to the market value of motor homes, and because Natiello's opinion failed to address any proper measure of damages for breach of warranty. It further ruled that Lester Schroeder's testimony regarding the value of the motor home was sufficient to withstand Barth's 12(b)(1) motion to establish federal jurisdiction. Thus, at a status conference on January 25, 1991, the case was set for trial.

[¶5] At the suggestion of the district court, Barth then filed a motion for summary judgment seeking to limit the Schroeders' damages to \$2,211.25, the cost averred in the Bibler affidavit to repair the Barth-warranted defects. Barth contended that the Schroeders wholly failed to present evidence to allow them to carry their burden at trial. The court agreed. In open court, on March 15, 1991, nearly ten years after the Schroeders purchased the motor home, the court granted Barth's motion for summary judgment on damages, and entered judgment for the Schroeders in the amount of \$2,113 plus costs.

The Schroeders appealed. On appeal, the court opined as follows:

[¶6] Because there is no dispute that a breach of Barth's express warranty occurred, and that the Schroeders sustained damages as a result of that breach, the only issue is the amount of those damages. Indiana's Uniform Commercial Code provides that the appropriate measure of damages for breach of an express warranty "is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount." IND.CODE Sec. 26-1-2-714(2). The alternative methods to calculate those damages * * * are (1) the cost to repair, (2) the fair market value of the goods as warranted less the salvage value of the goods, or (3) the fair market value of the goods as warranted at the time of acceptance less the fair market value of the goods as received at the time of acceptance. It is the Schroeders' burden to prove the amount of their damages, and theirs alone. * * * *

What does this rule require on appeal of the Schroeders' case? Which of these measures is the expectation measure? If you were trying to help them win at the trial court, what would you have prepared and tried to present as evidence? Why might a court choose cost of repair? One thing the court did affirm is that the owner of a good is competent to testify as to its value. The court in the end ruled for Barth. Why, do you suppose?

After you have considered the *Schroeder* case, consider also *Vreeman v. Davis*, 348 N.W.2d 756 (Minn. 1984), which addressed the following facts:

In March 1978, plaintiff-appellant Joseph Vreeman purchased a new mobile home from a local dealer for \$16,900. The mobile home was manufactured by defendant-respondent Champion Home Builders, Inc., and was installed by the local dealer onto a foundation erected by a contractor Vreeman had hired. Soon after installation, it was discovered that when it rained the mobile home leaked. After living in the home for 2½ years and attempting various repairs, Vreeman and his family moved out and thereafter commenced this lawsuit for damages against defendant Champion Home Builders and the local dealer. A default judgment was

entered against the dealer, who had left the state and apparently had gone out of business, leaving only the case against the manufacturer.

But the manufacturer was still available as a defendant, so the trial court held a 6-day trial. We have the following additional facts from trial:

Plaintiff Vreeman was never asked to give his opinion of the market value of the mobile home as warranted and as he received it. Instead, plaintiff testified only that he paid \$16,900 for the new mobile home, that his family lived in the home until December 1980, by which time "it wasn't fit to live in," and that "I wouldn't dare rent it." Nevertheless, the trial court gave plaintiff the benefit of the doubt and construed plaintiff's testimony to mean that the market value as warranted was \$16,900 and the value on the market (not just to plaintiff personally) as accepted was nothing. The trial court further ruled, however, "as a matter of law, that the mobile home had a market value at the time of its delivery and acceptance by the plaintiff. * * * [A]s a matter of law, * * * it has salvage value."

Vreeman appealed, and, in *Vreeman*, the court ruled for the Vreemans. Why? Are these two cases consistent?

2. Seller's Damages

Uniform Commercial Code §§ 2-703, 2-704, 2-705, 2-706, 2-708, 2-709, 2-710, 2-718

These seller's remedies provisions present the same kinds of difficulties as those for buyer's remedies. Section 2-703 is the seller's analogue to § 2-711. Please test your understanding by resolving the following hypotheticals:

a) Omicron Corp ordered 100 widgets at \$10 per widget from Rho, Inc., FOB Rho's plant. Rho delivered the widgets to Omicron's carrier at Rho's loading dock, and Omicron drove off with the goods. That was the last Rho heard from Omicron. Under common trade usage and the terms of Rho's invoice, which Omicron received with the goods, payment was due within 40 days. Seventy days have now passed. Rho's lawyer sent a demand letter twenty days ago, and Omicron will not answer phone calls. Under what section should Rho seek damages from Omicron? What damages will Omicron owe?

b) Sigma Corp ordered from Tau PrintCo a printing of 1,000 copies of Cervantes *Don Quixote* in English (an older translation on which all copyright had expired). Sigma agreed to pay \$10 per copy. Tau accepted the order, received the manuscript from Sigma, and prepared it for publication. Tau fired up the press and printed the pages. It also printed and prepared book covers. Before the pages had been bound, however, Sigma called and repudiated—it would not pay, it said. Tau now has all the pages and covers sitting in a warehouse. Tau has called around extensively, but it cannot find anyone who wants these pages or the bound book. The pages and covers are worth nothing. Each book would have

cost \$4 to produce. Tau has already spent an amount equivalent to \$3 per book. Under what section should Tau seek damages from Sigma? What damages will Sigma owe?

c) Mssrs. Nu and Mu contracted that Nu would sell Nu's horse to Mu for \$200,000. Then Mu called and said he would refuse the horse and not pay for it. Other buyers are willing to pay \$150,000 for the horse. Please consider the horse "identified" to the contract.

(i) Under what section should Nu seek damages from Mu? What damages will Mu owe?

(ii) Suppose that one week after Mu repudiated, Nu made a deal to sell the horse to another for \$150,000, a sale which later closed. Would that change your answer to (i)?

Do the statutes give the seller the right to consequential damages? Why, do you suppose? Please ignore the phrase "less expenses saved in consequence of the buyer's breach." It has the same meaning it did earlier.

Now, what about the following problem and the *Nobs* case?

PROBLEM 16: Neri contracted to buy a new boat from Retail Marine Corp. (RMC) for \$12,587.40. Neri deposited \$40. To get RMC to arrange with the manufacturer for immediate delivery, Neri increased the deposit to \$4,250. A few days later, Neri's lawyer sent to RMC a letter repudiating the contract. RMC had already ordered the boat; it was delivered to RMC at or before the time RMC received the letter. RMC declined to refund the deposit. Four months after RMC received the boat, RMC sold it to another buyer for the same price as that Neri had agreed to pay.

Neri then sued for the deposit. RMC counterclaimed, alleging breach and damages in the amount of the deposit. RMC claimed its profit on the boat in the sale to Neri would have been \$2,579, upkeep and storage for the boat cost \$674, and that it had incurred attorneys fees of \$1,250 in the suit later filed; however, RMC basically wants to keep the deposit as damages. The trial court granted partial summary judgment to RMC because Neri breached. The trial court awarded Neri the deposit, however, holding that RMC's claim for lost profits was invalid because RMC later sold the boat to another. The trial court let RMC retain \$500 pursuant to § 2-718 of the UCC. RMC appealed. What should be done? Please start with § 2-718(2) & (3), then go back to the other statutes. In particular, consider § 2-708(b). Can you make an argument that (2) is more appropriate than (1)? You will have to distinguish the boat from the horse. (Please disregard the phrase "due credit for payments or proceeds of resale.")

NOBS CHEMICAL, U.S.A., INC. and Calmon-Hill Trading Corp. v. KOPPERS CO.,
INC.

5th Cir. U.S. Ct. App. (1980), 616 F.2d 212

HENDERSON, C. J.:

[¶1] Koppers Company contracted with the plaintiffs, Nobs Chemical, U.S.A., Inc. (hereinafter referred to as "Nobs") and Calmon-Hill Trading Corporation (hereinafter referred to as "Calmon-Hill") to purchase 1000 metric tons of cumene.* Koppers breached the contract. Nobs and Calmon-Hill brought suit in United States District Court for the Southern District of Texas, and the case was tried before the court sitting without a jury.

[¶2] The district court found that the plaintiffs had arranged to purchase the cumene in Brazil for \$400.00 a ton and to expend \$45.00 per ton for the cost of transporting the cumene to the defendant, for a total expense of \$445,000.00. Koppers agreed to buy the cumene for \$540,000.00. The court applied Tex.Bus. & Com.Code § 2.708(b) (Vernon), and determined that the plaintiffs were entitled to recover their lost profits, \$95,000.00 (\$540,000.00 minus \$445,000.00). The district court ruled that the plaintiffs could not recover the extra \$25.00 per ton they allegedly were forced to pay their Brazilian supplier when the price per ton increased because their total order with the supplier was reduced from 4,000 metric tons to 3,000 metric tons because of Koppers' breach. The court decided this lost quantity discount amounted to consequential damages and was, therefore, not recoverable.

[¶3] Nobs and Calmon-Hill appeal the measure of damages applied by the district court, and, assuming it is correct, they challenge the computation of those damages. The defendant, Koppers, cross-appeals, also claiming that the district court's calculation of damages under the lost profits method was incorrect.

[¶4] We first turn to the issue of whether the district court was correct in applying the lost profits measure of damages to the plaintiffs' loss.

[¶5] According to Tex.Bus. & Com.Code Ann. § 2.708 (Vernon)
(a) . . . the measure of damages for non-acceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this chapter (Section 2.710), but less expenses saved in consequence of the buyer's breach.
(b) If the measure of damages provided in Subsection (a) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages

* Cumene is "a colorless oily hydrocarbon . . . used as an additive for high-octane motor fuel. . ." Webster's Third New International Dictionary 553 (1966).

provided in this chapter (Section 2.710), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale. The plaintiffs urge that subsection (a) should govern in this case. Because the market value of cumene dropped to between \$220.40 and \$264.48 a metric ton at the time of the breach, the plaintiffs contend that they should recover the difference between the contract price (\$540,000.00) and the market price (between \$220,400.00 and \$264,480.00), substantially more than the \$95,000.00 awarded them under subsection (b).

[¶6] There appears to be no Texas, nor any other state's, law directly on point. Under *Erie R. R. Co. v. Tompkins*, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938), a federal court must follow state law in a diversity case. Where no state court has decided the issue a federal court must "make an educated guess as to how that state's supreme court would rule." *Benante v. Allstate Ins. Co.*, 477 F.2d 553, 554 (5th Cir. 1973); *Smoot v. State Farm Mut. Auto. Ins. Co.*, 299 F.2d 525, 529 (5th Cir. 1962).

[¶7] Because there does not appear to be any law directly on point, we take the liberty of looking to those more learned on the subject of the Uniform Commercial Code. Professors White and Summers, recognizing that § 2.708(b) is not the most lucid or best-drafted of the sales article sections, decided that the drafters of the Uniform Commercial Code intended subsection (b) to apply to certain sellers whose losses would rarely be compensated by the subsection (a) market price-contract price measure of damages, and for these sellers the lost profit formula was added in subsection (b). One such type of seller is a "jobber," who, according to the treatise writers, must satisfy two conditions: "[f]irst, he is a seller who never acquires the contract goods. Second, his decision not to acquire those goods after learning of the breach was not commercially unreasonable. . . ." J. White & R. Summers, *Uniform Commercial Code* § 7-10, at 228 (1972) (hereinafter cited as "White & Summers"). Nobs and Calmon-Hill clearly fit this description. The plaintiffs never acquired the goods from their Brazilian supplier, and, as White and Summers point out, an action for the purchase price or resale was therefore unavailable. See, *Tex.Bus. & Com.Code Ann.* §§ 2.703, 2.704, 2.706, 2.709 (Vernon). See also, *American Metal Climax, Inc. v. Essex International, Inc.*, 16 U.C.C.Rep. 101, 115 (S.D.N.Y.1974) ("[C]ompensatory damages as provided in the contract-market formula of § 2-708(1) [§ 2.708(a)] are realistic only where the seller continues to be in a position to sell the product to other customers in the market.").

[¶8] The plaintiffs argue, however, that in this case the measure of damages under subsection (a) would adequately compensate them and therefore, according to the terms of subsection (a), subsection (b) does not control. This is an intriguing argument. It appears that the drafters of § 2.708(a) did not consider the possibility that recovery under that section may be more than adequate. White & Summers, *supra*, § 7-12, at 232-233.

[¶9] It is possible that the code drafters intended subsection (a) as a liquidated damage clause available to a plaintiff-seller regardless of his actual damages. There have been some commentators who agree with this philosophy. See, C. Goetz & R. Scott, *Measuring*

Sellers' Damages: the Lost-Profits Puzzle, 31 Stan.L.Rev. 323, 323-324 n. 2 (1979); E. Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two, 73 Yale L.J. 199, 259 (1963). But, this construction is inconsistent with the code's basic philosophy, announced in Tex.Bus. & Com.Code Ann. § 1.106(a) (Vernon) [now § 1-305], which provides "that the aggrieved party may be put in as good a position as if the other party had fully performed" but not in a better posture. White & Summers, *supra*, § 7-12, at 232. This philosophy is echoed in Texas case law. "The measure of damages for breach of contract is the amount necessary to place plaintiffs in a financial position equivalent to that in which it would have had [sic] if the contract had been fully performed by both parties." *Little Darling Corp. v. Ald, Inc.*, 566 S.W.2d 347, 349 (Tex.Civ.App.1978). Moreover, White and Summers conclude that statutory damage formulas do not significantly affect the practices of businessmen and therefore "breach deterrence," which would be the purpose of the statutory liquidated damages clause, should be rejected in favor of a standard approximating actual economic loss. White & Summers, *supra*, § 7-12, at 232. No one insists, and we do not think they could, that the difference between the fallen market price and the contract price is necessary to compensate the plaintiffs for the breach. Had the transaction been completed, their "benefit of the bargain" would not have been affected by the fall in market price, and they would not have experienced the windfall they otherwise would receive if the market price-contract price rule contained in § 2.708(a) is followed. Thus, the premise contained in § 1.106 and Texas case law is a strong factor weighing against application of § 2.708(a).

[¶10] Our conclusion [is] that the district court was correct in applying § 2.708(b) * * * .

Questions:

1. Can Nobs recover under § 2-708(1)? Why?
2. What do we learn about the lost volume seller rule in this case?
3. Liquidated Damages

TRUCK RENT-A-CENTER, INC. v. PURITAN FARMS 2nd, INC.
N.Y. (1977), 361 N.E.2d 1015

[¶1] The principal issue on this appeal is whether a provision in a truck lease agreement which requires the payment of a specified amount of money to the lessor in the event of the lessee's breach is an enforceable liquidated damages clause, or, instead, provides for an unenforceable penalty.

[¶2] Defendant Puritan Farms 2nd, Inc. (Puritan), was in the business of furnishing milk and milk products to customers through home delivery. In January, 1969, Puritan leased a fleet of 25 new milk delivery trucks from plaintiff Truck Rent-A-Center for a term of seven

years commencing January 15, 1970. Under the provisions of a truck lease and service agreement entered into by the parties, the plaintiff was to supply the trucks and make all necessary repairs. Puritan was to pay an agreed upon weekly rental fee. It was understood that the lessor would finance the purchase of the trucks through a bank, paying the prime rate of interest on the date of the loan plus 2%. The rental charges on the trucks were to be adjusted in the event of a fluctuation in the interest rate above or below specified levels. The lessee was granted the right to purchase the trucks, at any time after 12 months following Commencement of the lease, by paying to the lessor the amount then due and owing on the bank loan, plus an additional \$ 100 per truck purchased.

[¶3] Article 16 of the lease agreement provided that if the agreement should terminate prior to expiration of the term of the lease as a result of the lessee's breach, the lessor would be entitled to damages, "liquidated for all purposes", in the amount of all rents that would have come due from the date of termination to the date of normal expiration of the term less the "re-rental value" of the vehicles, which was set at 50% of the rentals that would have become due. In effect, the lessee would be obligated to pay the lessor, as a consequence of breach, one half of all rentals that would have become due had the agreement run its full course. The agreement recited that, in arriving at the settled amount of damage, "the parties hereto have considered, among other factors, Lessor's substantial initial investment in purchasing or reconditioning for Lessee's service the demised motor vehicles, the uncertainty of Lessor's ability to re-enter the said vehicles, the costs to Lessor during any period the vehicles may remain idle until re-rented, or if sold, the uncertainty of the sales price and its possible attendant loss. The parties have also considered, among other factors, in so liquidating the said damages, Lessor's saving in expenditures for gasoline, oil and other service items."

[¶4] The bulk of the written agreement was derived from a printed form lease which the parties modified by both filling in blank spaces and typing in alterations. The agreement also contained several typewritten indorsements which also made changes in the provisions of the printed lease. The provision for lessee's purchase of the vehicles for the bank loan balance and \$100 per vehicle was contained in one such indorsement. The liquidated damages clause was contained in the body of the printed form.

[¶5] . . . After nearly three years, the lessee sought to terminate the lease agreement. On December 7, 1973, Puritan wrote to the lessor complaining that the lessor had not repaired and maintained the trucks as provided in the lease agreement. Puritan stated that it had "repeatedly notified" plaintiff of these defaults, but plaintiff had not cured them. Puritan, therefore, exercised its right to terminate the agreement "without any penalty and without purchasing the trucks". * * * On the date set for termination, December 14, 1973, plaintiff's attorneys replied to Puritan by letter to advise it that plaintiff believed it had fully performed its obligations under the lease and, in the event Puritan adhered to the announced breach, would commence proceedings to obtain the liquidated damages provided for in article 16 of the agreement. Nevertheless, Puritan had its drivers return the trucks to

plaintiff's premises, where the bulk of them have remained ever since. At the time of termination, plaintiff owed \$45,134.17 on the outstanding bank loan.

[¶6] Plaintiff followed through on its promise to commence an action for the payment of the liquidated damages. Defendant counterclaimed for the return of its security deposit. At the nonjury trial, plaintiff contended that it had fully performed its obligations to maintain and repair the trucks. Moreover, it was submitted, Puritan sought to cancel the lease because corporations allied with Puritan had acquired the assets, including delivery trucks, of other dairies and Puritan believed it cheaper to utilize this "shadow fleet". The home milk delivery business was on the decline and plaintiff's president testified that efforts to either re-rent or sell the truck fleet to other dairies had not been successful. Even with modifications in the trucks, such as the removal of the milk racks and a change in the floor of the trucks, it was not possible to lease the trucks to other industries, although a few trucks were subsequently sold. The proceeds of the sales were applied to the reduction of the bank balance. The other trucks remained at plaintiff's premises, partially protected by a fence plaintiff erected to discourage vandals. The defendant countered with proof that plaintiff had not repaired the trucks promptly and satisfactorily.

[¶7] At the close of the trial, the court found, based on the evidence it found to be credible, that plaintiff had substantially performed its obligations under the lease and that defendant was not justified in terminating the agreement. Further, the court held that the provision for liquidated damages was reasonable and represented a fair estimate of actual damages which would be difficult to ascertain precisely. "The parties, at the time the agreement was entered into, considered many factors affecting damages, namely: the uncertainty of the plaintiff's ability to re-rent the said vehicles; the plaintiff's investment in purchasing and reconditioning the vehicles to suit the defendant's particular purpose; the number of man hours not utilized in the non-service of the vehicles in the event of a breach; the uncertainty of reselling the vehicles in question; the uncertainty of the plaintiff's savings or expenditures for gasoline, oil or other service items, and the amount of fluctuating interest on the bank loan." The court calculated that plaintiff would have been entitled to \$ 177,355.20 in rent for the period remaining in the lease and, in accordance with the liquidated damages provision, awarded plaintiff half that amount, \$ 88,677.60. The resulting judgment was affirmed by the Appellate Division, with two Justices dissenting. (51 AD2d 786.)

[¶8] The primary issue before us is whether the "liquidated damages" provision is enforceable. Liquidated damages constitute the compensation which, the parties have agreed, should be paid in order to satisfy any loss or injury flowing from a breach of their contract. * * * * In effect, a liquidated damage provision is an estimate, made by the parties at the time they enter into their agreement, of the extent of the injury that would be sustained as a result of breach of the agreement. * * * * Parties to a contract have the right to agree to such clauses, provided that the clause is neither unconscionable nor contrary to public policy. * * * * Provisions for liquidated damage have value in those situations where it would be difficult, if not actually impossible, to calculate the amount of actual damage.

In such cases, the contracting parties may agree between themselves as to the amount of damages to be paid upon breach rather than leaving that amount to the calculation of a court or jury. * * * *

[¶9] On the other hand, liquidated damage provisions will not be enforced if it is against public policy to do so and public policy is firmly set against the imposition of penalties or forfeitures for which there is no statutory authority. * * * * It is plain that a provision which requires, in the event of contractual breach, the payment of a sum of money grossly disproportionate to the amount of actual damages provides for penalty and is unenforceable. * * * * A liquidated damage provision has its basis in the principle of just compensation for loss. * * * * A clause which provides for an amount plainly disproportionate to real damage is not intended to provide fair compensation but to secure performance by the compulsion of the very disproportion. A promisor would be compelled, out of fear of economic devastation, to continue performance and his promisee, in the event of default, would reap a windfall well above actual harm sustained. * * * * As was stated eloquently long ago, to permit parties, in their unbridled discretion, to utilize penalties as damages “would lead to the most terrible oppression in pecuniary dealings.” * * * *

[¶10] The rule is now well established. A contractual provision fixing damages in the event of breach will be sustained if the amount liquidated bears a reasonable proportion to the probable loss and the amount of actual loss is incapable or difficult of precise estimation. * * * * If, however, the amount fixed is plainly or grossly disproportionate to the probable loss, the provision calls for a penalty and will not be enforced. * * * *

[¶11] In applying these principles to the case before us, we conclude that the amount stipulated by the parties as damages bears a reasonable relation to the amount of probable actual harm and is not a penalty. Hence, the provision is enforceable and the order of the Appellate Division should be affirmed.

[¶12] Looking forward from the date of the lease, the parties could reasonably conclude, as they did, that there might not be an actual market for the sale or re-rental of these specialized vehicles in the event of the lessee's breach. To be sure, plaintiff's lost profit could readily be measured by the amount of the weekly rental fee. However, it was permissible for the parties, in advance, to agree that the re-rental or sale value of the vehicles would be 50% of the weekly rental. Since there was uncertainty as to whether the trucks could be re-rented or sold, the parties could reasonably set, as they did, the value of such mitigation at 50% of the amount the lessee was obligated to pay for rental of the trucks. This would take into consideration the fact that, after being used by the lessee, the vehicles would no longer be "shiny, new trucks", but would be used, possibly battered, trucks, whose value would have declined appreciably. The parties also considered the fact that, although plaintiff, in the event of Puritan's breach, might be spared repair and maintenance costs necessitated by Puritan's use of the trucks, plaintiff would have to assume the cost of storing and maintaining trucks idled by Puritan's refusal to use them.

Further, it was by no means certain, at the time of the contract, that lessee would peacefully return the trucks to the lessor after lessee had breached the contract. * * * *

[¶13] We attach no significance to the fact that the liquidated damages clause appears on the preprinted form portion of the agreement. The agreement was fully negotiated and the provisions of the form, in many other respects, were amended. * * * *

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

Question: Would this case be a correct application of UCC § 2-718(1)?

IV. Third-Party Rights and Obligations

Conceptually, people who are not parties to a contract obtain interests in them in three ways:

- (1) Duties might be delegated to them to do. For example, a general contractor delegates many of its construction duties to subcontractors.
- (2) Rights might be assigned. Your mortgage originator usually will transfer its rights to your payments to someone else.
- (3) The parties might agree that one of them is contracting for the benefit of someone else, so that that third party will have the benefit (which is why we call that person a third-party beneficiary). A parent might buy life insurance and name a child as a beneficiary, for instance.

Though, conceptually, there are three primary ways to involve third parties, courts do not keep the vocabulary tidy. For instance, they often talk of “assigning a contract” which contains both rights and duties. See if you can distinguish between duties and rights and determine which the court is talking about when.

Third-party beneficiary law can also be tricky because so many contracts are arguably for the benefit of others, and each situation is to some extent unique. Moreover, courts have offered a couple of tests for whether legal rights arise. Using the court’s rule language as a guide in combination with examples like life insurance and a couple of cases, can you tell from the materials why a court did and when a court would grant legal rights under a contract to a third party?

A. Assignment

FITZROY v. CAVE Court of Appeal (1905), 2 K.B. 364

[¶1] Appeal from the judgment of Lawrance J. in an action tried before him without a jury.

[¶2] The action was brought by the plaintiff as the assignee of certain debts.

[¶3] It appeared that the defendant was at the date of the after-mentioned deed indebted to five tradesmen in Ireland in various sums, amounting in all to 90l. 11s. 5d., in respect of goods sold and delivered by them respectively to him. By a deed dated October 13, 1904, and made between these tradesmen of the one part and the plaintiff of the other part, after reciting that the parties of the first part had agreed to assign the said debts to the plaintiff upon the terms and for the consideration thereafter set forth, it was witnessed that, in pursuance of such agreement, and for and in consideration of the covenant and agreement on the part of the plaintiff thereafter contained, the parties of the first part thereby respectively assigned to the plaintiff the said debts to hold the same respectively to the plaintiff absolutely. The deed then proceeded: "And the assignee hereby covenants with the assignors, and with each of them, that, in case he shall be able to recover and realize the amount of the said debts from the said Arthur Oriel Singer Cave, he will immediately thereupon pay over to them, the assignors, their executors, administrators, and assigns, the said respective amounts, or so much thereof as he may be able to recover or realize, after payment of all costs necessarily incurred by him." Notice in writing of this assignment had been given to the defendant.

[¶4] It appeared in evidence that the plaintiff was interested in, and a director of, a company called the Cork Mineral Development Company. The defendant was a co-director and the local manager of the company. The plaintiff, being dissatisfied with the action of the defendant as a director of the company, had, acting under the advice of a solicitor, taken the assignment of the before-mentioned debts with the view of procuring an adjudication in bankruptcy against the defendant, and so getting him removed from the directorate of the company.

[¶5] Lawrance J. held, with some doubt, that, under these circumstances, the assignment was invalid as savouring of maintenance or otherwise against public policy, and therefore gave judgment for the defendant.

[¶6] May 25. Roskill, K.C., and Raymond Asquith, for the plaintiff. Maintenance is where a person maintains a litigation, having no interest in the subject-matter of it, nor any relation to the litigant which justifies him in doing so * * *. The plaintiff in this case being the assignee for good consideration, and legal owner of these debts, cannot possibly be said to have had no interest in the subject-matter of the litigation. * * * It is submitted that the

law cannot inquire into the motives with which an assignment of debts prima facie lawful is procured. A lawful transaction cannot be made unlawful on account of the inner motives of the person entering into it * * * . The present case stands on the same footing legally as if the plaintiff had purchased these debts for cash. * * * *

[¶7] Holman Gregory, for the defendant. On the assumption that the assignment of the debts to the plaintiff was valid in law, it no doubt easily follows that there is nothing in the nature of maintenance in the transaction. But this assumption really begs the whole question. It may be admitted that there was a good legal assignment of the debts in point of form, but a transaction in which substance contravenes public policy, or savours of maintenance, cannot be made good by being clothed in a legal dress. It is submitted that to purchase a right of action with such a collateral and indirect motive as actuated the plaintiff in this case savours of maintenance, even if it does not come exactly within the definition of it; and the authorities shew that the law will not recognise such a purchase as valid. It is a transaction which brings about litigation, which would never have been initiated by the creditors themselves, and that not by way of a bona fide commercial speculation, but with a sinister and malicious purpose. Moreover, there was not in this case, in substance, a purchase of these debts. The plaintiff had really no interest in the debts themselves, and his only interest in the litigation was of a collateral and indirect character. * * * *

[¶8] Cozens-Hardy L.J. read the following judgment: –This is an appeal from the judgment of Lawrance J. in favour of defendant. The plaintiff is the assignee of five debts amounting together to over 50l. due from the defendant to five creditors resident in Ireland. The assignment is effected by a deed dated October 13, 1904. It is in the common form of an absolute assignment, but there is no pecuniary consideration, and the assignee takes no beneficial interest, for he covenants that, in case he is able to recover the amount of the debts from the defendant, he will pay over to the assignors the respective amounts or so much thereof as he may be able to recover or realize after payment of all costs necessarily incurred by him. Now the existence of the debts is not disputed, and unless the plaintiff can recover the amounts the defendant has been relieved from all responsibility. It has, however, been strenuously contended by Mr. Gregory in his very able argument that the plaintiff's action is open to the objection of maintenance, or is otherwise such that on grounds of public policy the Court ought to refuse its assistance. This view was adopted by the learned judge.

[¶9] It is desirable to consider the limits of the doctrine of maintenance as applied to choses in action. There are undoubtedly many choses in action which are not and never were assignable either at law or in equity. * * * *

[¶10] There are, however, other choses in action which, though not assignable at common law, were always regarded as assignable in equity. A debt presently due and payable is an instance. At common law such a debt was looked upon as a strictly personal obligation, and an assignment of it was regarded as a mere assignment of a right to bring an action at law against the debtor. Hence an assignment was, with some exceptions which need not be

referred to (see 1 Hawkins' Pleas of the Crown, p. 458), looked upon as open to the objection of maintenance. After a time the Common Law Courts recognised the right of any one who had a pecuniary interest in the debt to sue in the name of the debtor. This, however, was the limit of their departure from the old strict rule, so far as I have been able to discover. But the Courts of Equity took a different view: *Row v. Dawson*. They admitted the title of an assignee of a debt, regarding it as a piece of property, an asset capable of being dealt with like any other asset, and treating the necessity of an action at law to get it in as a mere incident. They declined to hold such a transaction open to the charge of maintenance. * * * A Court of Equity recognised not merely transactions which amounted to sales or mortgages of debts, under which the assignee took a beneficial interest in the debt, but also the creation of trusts, under which the trustee took no interest. Thus A., the creditor, might assign the debt to B., with or without a power of attorney, upon trust for C. Or A. might simply declare himself a trustee of the debt for C. In either case the trustee would take no beneficial interest, and would, by virtue of his position as trustee, be entitled to be indemnified out of the moneys recovered against all costs of the action brought in the name of A. against the debtor. If the debt were secured by a promissory note or bill or other negotiable instrument, A. might deliver the instrument to B. upon trust for C., and B. could sue at law on it. Or A. might create a trust in favour of himself by delivering the instrument to B. upon trust for himself. It would, I apprehend, in this case be no objection to say that B. had no interest in the debt. It has never, so far as I am aware, been suggested that a trustee to whom a debt is assigned is exposed to a charge of maintenance. Mortgages are every day dealt with in this fashion, including an assignment of the debt. From time to time particular classes of obligation have by statute been rendered assignable at law, and by the Judicature Act, 1873, s. 25, sub-s. 6, any debt is made assignable at law by an absolute assignment in writing, of which notice is given to the debtor. Henceforth in all Courts a debt must be regarded as a piece of property capable of legal assignment in the same sense as a bale of goods. And on principle I think it is not possible to deny the right of the owner of any property capable of legal assignment to vest that property in a trustee for himself, and thereby to confer upon such trustee a right of indemnity. It is not easy to see how the doctrine of maintenance can be applied to a case like the present. * * * The plaintiff is merely seeking by this action to recover payment of debts admitted to be justly due. It is said that the plaintiff does not really desire to be paid and can take nothing for his own benefit under the judgment. For the reasons above stated I think this is of no moment. It is further argued that his only object is to obtain a judgment which may serve as the foundation of bankruptcy proceedings, the ultimate result of which will be the removal of the defendant from his position as director of a company in which the plaintiff is largely interested. But I fail to see that we have anything to do with the motives which actuate the plaintiff, who is simply asserting a legal right consequential upon the possession of property which has been validly assigned to him. If the defendant pays, no bankruptcy proceedings will follow. If he does not pay, bankruptcy is a possible result. In my opinion this appeal must be allowed.

Mathew L.J. agrees with this judgment.
Appeal allowed.

Questions:

1. What is maintenance? One attorney claimed that “the common law made it unlawful to solicit claims, to render aid where there was no interest, to institute fraudulent claims, and to acquire a contingent interest in causes of action, because contrary to public policy.” *McCloskey v. San Antonio Traction Co.*, 192 S.W. 1116, 1118 (Tex. App. 1917). Obviously, we do not follow this kind of rule now, at least not as lawyers. The court in *Fitzroy* suggests that instead claims can be solicited, aid rendered where there is no interest, and legally recognized assignments made to those who in fact mean to harm the interests of the debtor. Do you see anything immoral in this? Inefficient?

2. Do debtors care about the identity of their creditors? The money is owed in any event, right? Why should anyone care to whom it is paid? Consider the facts of the following case:

MBank El Paso hired El Paso Recovery Service to repossess Yvonne Sanchez's automobile because of her default on a note. Two men dispatched to Sanchez's home found the car parked in the driveway, and hooked it to a tow truck. Sanchez demanded that they cease their efforts and leave the premises; but the men nonetheless continued with the repossession. Before the men could tow the automobile into the street, Sanchez jumped into the car, locked the doors, and refused to leave. The men then towed the car at a high rate of speed, with Sanchez inside, to the repossession yard. They parked the car in the fenced repossession yard and padlocked the gate. Sanchez was left in the repossession lot, with a Doberman pinscher guard dog loose in the yard, until later rescued by her husband and police.

Mbank El Paso, N.A. v. Sanchez, 836 S.W.2d 151 (Tex. 1992). The Texas Supreme Court in this case held that, pursuant to UCC § 9-503 (prohibiting breach of the peace in self-help repossession), the bank could be liable for breaches of the peace committed by an independent contractor. MBank hired El Paso Recovery Service to collect the car, but it could also have assigned the debt to them. Should you care who owns your debt?

Uniform Commercial Code § 2-210

The EVENING NEWS ASSOCIATION v. Gordon PETERSON
D. D.C. (1979), 477 F. Supp. 77

PARKER, J.:

[¶1] The question presented in this litigation is whether a contract of employment between an employee and the owner and licensee of a television station, providing for the employee's services as a newscaster-anchorman, was assigned when the station was sold and acquired by a new owner and licensee.

[¶2] Plaintiff Evening News Association (Evening News) a Michigan Corporation, acquired station WDVM-TV (Channel 9) a District of Columbia television station from Post-Newsweek Stations, Inc. (Post-Newsweek) in June of 1978. At that time, the defendant Gordon Peterson was and had been employed for several years as a newscaster-anchorman by Post-Newsweek. This defendant is a citizen of the State of Maryland. The plaintiff claims that Peterson's employment contract was assignable without the latter's consent, was indeed assigned, and thus otherwise enforceable. The defendant contends, however, that his Post-Newsweek contract required him to perform unique and unusual services and because of the personal relationship he had with Post-Newsweek the contract was not assignable.

[¶3] Mr. Peterson was employed by the plaintiff for more than one year after the acquisition and received the compensation and all benefits provided by the Post-Newsweek contract. In early August, 1979, he tendered his resignation to the plaintiff. At that time the defendant had negotiated an employment contract with a third television station located in the District of Columbia, a competitor of the plaintiff. The Evening News then sued Peterson, seeking a declaration of the rights and legal relations of the parties under the contract and permanent injunctive relief against the defendant.

[¶4] Following an accelerated briefing schedule and an expedited bench trial on the merits, the Court concludes that the contract was assignable and that Evening News is entitled to appropriate permanent injunctive relief against the defendant Gordon Peterson.

[¶5] In accordance with Rule 52(a) Fed.R. Civ.P., the Court's findings of fact and conclusions of law in support of that determination are set forth.

FINDINGS OF FACT

[¶6] The defendant was employed by Post-Newsweek Stations, Inc. from 1969 to 1978. During that period he negotiated several employment contracts. Post-Newsweek had a license to operate television station WTOP-TV (Channel 9) in the District of Columbia. In June of 1978, following approval by the Federal Communications Commission, Post-Newsweek sold its operating license to Evening News and Channel 9 was then designated WDVM-TV. A June 26, 1978, Bill of Sale and Assignment and Instrument of Assumption and Indemnity between the two provided in pertinent part:

PNS has granted, bargained, sold, conveyed and assigned to ENA, . . . all the property of PNS . . . including, . . . all right, title and interest, legal or equitable, of PNS in, to and under all agreements, contracts and commitments listed in Schedule A hereto. . . .

[¶7] When Evening News acquired the station, Peterson's Post-Newsweek employment contract, dated July 1, 1977, was included in the Bill of Sale and Assignment. The contract was for a three-year term ending June 30, 1980, and could be extended for two additional

one-year terms, at the option of Post-Newsweek. The significant and relevant duties and obligations under that contract required Peterson:

to render services as a news anchorman, and to perform such related services as news gathering, writing and reporting, and the organization and preparation of program material, to the extent required by the Stations, as are consistent with [his] primary responsibility as a news anchorman. . . . [To participate] personally as a newsman, announcer, on-the-air personality or other performer in any news, public affairs, documentary, news analysis, interview, special events or other program or segment of any program, designated by . . . and to the extent required by the Stations . . . as may reasonably be required by the Stations. . . .

[¶8] As compensation the defendant was to receive a designated salary which increased each year from 1977 through the fifth (option) year. Post-Newsweek was also obligated to provide additional benefits including term life insurance valued at his 1977 base salary, disability insurance, an annual clothing allowance and benefits to which he was entitled as provided in an underlying collective bargaining agreement with the American Federation of Television and Radio Artists.

[¶9] There was no express provision in the 1977 contract concerning its assignability or nonassignability. However, it contained the following integration clause:

This agreement contains the entire understanding of the parties . . . and this agreement cannot be altered or modified except in a writing signed by both parties.

A.

[¶10] Aside from the various undisputed documents and exhibits admitted into evidence, there were sharp conflicts in testimony concerning various events and what was said and done by the parties and their representatives, both before and after the Evening News' acquisition. As trier of fact, having heard and seen the several witnesses testify and after assessing and determining their credibility, the Court makes the following additional findings.

[¶11] The defendant's duties, obligations and performance under the 1977 contract did not change in any significant way after the Evening News' acquisition. In addition, the Evening News met all of its required contract obligations to the defendant and its performance after acquisition in June, 1978, was not materially different from that of Post-Newsweek.

[¶12] Mr. Peterson testified that he had "almost a family relationship" with James Snyder, News Director, and John Baker, Executive Producer, for Post-Newsweek, which permitted and promoted a free exchange of ideas, frank expressions of dissent and criticism and open lines of communication. These men left Channel 9 when Post-Newsweek relinquished its license, and they have since been replaced by Evening News personnel. According to Mr. Peterson, the close relationship and rapport which existed between him and them was an

important factor as he viewed the contract; these relationships made the contract in his view nonassignable and indeed their absence at the Evening News prevented defendant from contributing his full efforts. Even if Mr. Peterson's contentions are accepted, it should be noted that he contracted with the Post-Newsweek corporation and not with the News Director and Executive Producer of that corporation. Indeed, the 1977 contract makes no reference to either officer, except to provide that vacations should be scheduled and coordinated through the News Director. Had the defendant intended to condition his performance on his continued ability to work with Snyder and Baker, one would have expected the contract to reflect that condition.

[¶13] The close, intimate and personal relationship which Mr. Peterson points to as characterizing his association with Post-Newsweek and its personnel, was highly subjective and was supported only by his testimony. The Court cannot find that Peterson contracted with Post-Newsweek in 1977 to work with particular individuals or because of a special policy-making role he had been selected to perform in the newsroom. For the fourteen-month period of Peterson's employment at the Evening News, there is no showing that he was in any way circumscribed, limited in his work or otherwise disadvantaged in his performance. Nor is there any credible evidence that the News Director or other top personnel of Evening News were rigid, inflexible, warded off any of Mr. Peterson's criticisms or even that at any time he gave suggestions and criticisms which were ignored or rejected. Finally, the Court does not find that Post-Newsweek contracted with Peterson because of any peculiarly unique qualities or because of a relationship of personal confidence with him.

B.

[¶14] In his direct testimony, Mr. Peterson expressed a degree of disappointment because of Evening News' failure to keep pace with advances in technology and to seize opportunities for live in-depth coverage of current events. He characterized the plaintiff's news coverage as "less aggressive" than what he had experienced with Post-Newsweek.

[¶15] On cross-examination, however, he was shown an exhibit comparing the broadcast of special assignments reported and produced by him for two one-year periods, one before and one after the June, 1978 acquisition. While he admitted to its accuracy with some reservation, the exhibit clearly showed that a comparable number of such assignments of similar quality, were broadcast within the two years. He also conceded that for the same period Evening News received two Peabody awards, an award for best editorials, and a number of Emmy awards for public affairs exceeding those received in prior years by Post-Newsweek. Finally, he acknowledged that Channel 9 still maintained the highest ratings for audience viewing among the television stations in the Washington, D.C. market area.

[¶16] A great amount of testimony was generated as to when Peterson learned of the Evening News' acquisition and what then occurred relative to the assignment of the contract. The testimony on this issue was conflicting, largely cumulative and as now

viewed, over-emphasized by the parties. The Court finds that the defendant gained first knowledge of a possible sale and transfer of the station in December, 1977. At that time, the president of Post-Newsweek publicly announced to the station's employees, including Peterson, that an agreement in principle had been reached, subject to approval by the Federal Communications Commission. At no time from December, 1977, until December, 1978, did the defendant or his attorney ever indicate or venture an opinion that the contract was not assignable. Indeed, through at least April, 1979, the defendant's attorney made representations that assignment of the contract presented no problem to his client.

[¶17] In summary, the Court finds that the performance required of Mr. Peterson under the 1977 contract was (1) not based upon a personal relationship or one of special confidence between him and Post-Newsweek or its employees, and (2) was not changed in any material way by the assignment to the Evening News.

CONCLUSIONS OF LAW

[¶18] There is diversity of citizenship; the amount in controversy exceeds \$10,000; and the Court has jurisdiction over this proceeding by virtue of 28 U.S.C. § 1332.

A.

[¶19] The distinction between the assignment of a right to receive services and the obligation to provide them is critical in this proceeding. This is so because duties under a personal services contract involving special skill or ability are generally not delegable by the one obligated to perform, absent the consent of the other party. The issue, however, is not whether the personal services Peterson is to perform are delegable but whether Post-Newsweek's right to receive them is assignable.

[¶20] Contract rights as a general rule are assignable. *Munchak Corp. v. Cunningham*, 457 F.2d 721 (4th Cir. 1972); *Meyer v. Washington Times Co.*, 64 App.D.C. 218, 76 F.2d 988 (D.C.Cir.) cert. denied 295 U.S. 734, 55 S.Ct. 646, 79 L.Ed. 1682 (1935); 4 A. Corbin, *Contracts* § 865 (1951); *Restatement (First) of Contracts* § 151 (1932). This rule, however, is subject to exception where the assignment would vary materially the duty of the obligor, increase materially the burden of risk imposed by the contract, or impair materially the obligor's chance of obtaining return performance. *Corbin* § 868; *Restatement* § 152. There has been no showing, however, that the services required of Peterson by the Post-Newsweek contract have changed in any material way since the Evening News entered the picture. Both before and after, he anchored the same news programs. Similarly he has had essentially the same number of special assignments since the transfer as before. Any additional policy-making role that he formerly enjoyed and is now denied was neither a condition of his contract nor factually supported by other than his own subjective testimony.

[¶21] The general rule of assignability is also subject to exception where the contract calls for the rendition of personal services based on a relationship of confidence between the parties. *Munchak*, 457 F.2d at 725; *Meyer*, 64 App.D.C. at 219, 76 F.2d at 989. As Corbin has explained this limitation on assignment:

In almost all cases where a "contract" is said to be non-assignable because it is "personal," what is meant is not that the contractor's right is not assignable, but that the performance required by his duty is a personal performance and that an attempt to perform by a substituted person would not discharge the contractor's duty.

Corbin § 865. In *Munchak*, the Court concluded that a basketball player's personal services contract could be assigned by the owner of the club to a new owner, despite a contractual prohibition on assignment to another club, on the basis that the services were to the club. The Court found it "inconceivable" that the player's services "could be affected by the personalities of successive corporate owners." 457 F.2d at 725. The policy against the assignment of personal service contracts, as the Court noted, "is to prohibit an assignment of a contract in which the obligor undertakes to serve only the original obligee." 457 F.2d at 726.

[¶22] Given the silence of the contract on assignability, its merger clause, and the usual rule that contract rights are assignable, the Court cannot but conclude on the facts of this case that defendant's contract was assignable. Mr. Peterson's contract with Post-Newsweek gives no hint that he was to perform as other than a newscaster-anchorman for their stations. Nor is there any hint that he was to work with particular Post-Newsweek employees or was assured a policy-making role in concert with any given employees. Defendant's employer was a corporation, and it was for Post-Newsweek Stations, Inc. that he contracted to perform. The corporation's duties under the contract did not involve the rendition of personal services to defendant; essentially they were to compensate him. Nor does the contract give any suggestion of a relation of special confidence between the two or that defendant was expected to serve the Post-Newsweek stations only so long as the latter had the license for them.

B.

[¶23] As noted, the 1977 contract contained a clause providing that the entire understanding between the parties was contained within the four corners of the agreement. The contract contains no provision relating to assignment. The defendant's counsel asserts, however, that an ambiguity exists and he therefore seeks to introduce certain exhibits and other extrinsic evidence for purposes of explaining and discerning the intentions of the parties. Specifically, he seeks to introduce four documents: an earlier 1973 contract; a draft of a proposed 1974 contract; the final 1974 contract; and a letter of 1975 from the president of Post-Newsweek to the defendant. The Court reserved decision on admissibility of the exhibits and now rules that they are inadmissible for the purposes intended by the defendant. The 1977 contract makes no reference to any prior agreements, to any negotiations between the parties, or specifically to the four proffered exhibits. To make use

of them to show the intention of the parties in 1977, or to show what happened in past contract negotiations, simply asks too much.

[¶24] The Court does not share the defendant's belief that silence on the issue of assignability creates ambiguity, and he fails to provide any legal authority to warrant such an inference. An unsupported assertion that ambiguity exists is insufficient to give a different meaning to a contract when there is in fact no contractual provision. For the Court to accept the defendant's exhibits in an effort to explain the parties' intent would modify and enlarge the provisions of the agreement and bestow upon the defendant an advantage which he did not originally have. The law of this Circuit is clearly set forth in *Clayman v. Goodman Properties, Inc.*, 171 U.S.App.D.C. 88, 95, 518 F.2d 1026, 1033 (D.C.Cir. 1973), where Circuit Judge Robinson said in part:

[W]e perceive no basis for resort to evidence depicting the circumstances surrounding the making of the contract before us. We need do little more than reiterate that "[t]he parol evidence rule requires that '[w]hen two parties have made a contract and have expressed it in a writing to which they have both assented as the complete and accurate integration of that contract, evidence, whether parol or otherwise, of antecedent understandings and negotiations will not be admitted for the purpose of varying or contradicting the writing.'" The consequences which the law attaches to a written contract are as much a part of it as the terms it sets forth, and the legal effect of the contract can no more be changed or modified by parol evidence than it could have had it been made express.

[¶25] The contract before the Court, as the agreement in *Clayman*, contains a merger clause stating that the contract embodies the final and exclusive understanding of the parties. Such a stipulation is given full effect in this jurisdiction absent the Court's finding of any ambiguity in the contract. *Lee v. Flintkote Co.*, 193 U.S.App.D.C. 121, 127, 593 F.2d 1275, 1281 (D.C.Cir. 1979).

C.

[¶26] Plaintiff's argument that defendant has waived any objection to the assignment by accepting the contract benefits and continuing to perform for the Evening News for over a year has perhaps some merit. If defendant has doubts about assignability, he should have voiced them when he learned of the planned transfer or at least at the time of transfer. His continued performance without reservation followed by the unanticipated tender of his resignation did disadvantage Evening News in terms of finding a possible replacement for him and possibly in lost revenues. The Court, however, concludes that the contract was assignable in the first instance and thus it is not necessary to determine whether defendant's continued performance constitutes a waiver of objection to the assignment.

[¶27] During the course of this trial Edwin W. Pfeiffer, an executive officer of WDM-TV, testified that Mr. Peterson allegedly stated "if the Judge decides I should stay, I will stay." Assuming that he did not overstate Mr. Peterson's position and that Mr. Peterson was

quoted in appropriate context, the television audience of the Washington, D.C. metropolitan area should anticipate his timely reappearance as news anchorman for station WDM-TV. Of course, the avenue of appeal is always available.

[¶28] An order consistent with this Memorandum Opinion will be entered. Counsel for the plaintiff shall submit immediately an appropriate order.

Questions:

1. What was the injunctive relief against Peterson?
2. Why did Peterson quit, do you suppose?
3. Peterson continued at Channel 9 until 2003, when he moved to Channel 7. He left Channel 7 at the end of 2014. Why do you suppose Channel 9 still wanted him?
4. Generally, rights are assigned and duties are delegated. The rules for transferring each to a non-party differ. Which was at issue in *Peterson*?

Stephen A. DILLMAN v. TOWN OF HOOKSETT
N.H. (2006), 153 N.H. 344

[¶1] Whether, under New Hampshire law, including N.H. RSA 273-A, an individual public sector union member may be assigned his union's right under N.H. RSA 542:8 to seek a vacation, confirmation, correction, or modification of an arbitration award entered in an arbitration conducted pursuant to a collective bargaining agreement between the member's union and his employer.

[¶2] We respond in the negative.

[¶3] The district court's order provides the following facts. The defendant, Town of Hooksett (Hooksett), terminated the employment of the plaintiff, Stephen Dillman, on May 24, 2002. At the time of his termination, Dillman was a member of the Hooksett Permanent Firefighter Association I.A.F.F., Local 3264 (the Union), which served as a certified union for Hooksett firefighters. The Union's collective bargaining agreement with Hooksett included a grievance article that specifically provided it was subject to the provisions of RSA chapter 542.

[¶4] The Union filed a grievance with Hooksett on behalf of Dillman following his termination. Arbitration was held in accordance with the collective bargaining agreement, resulting in an award by the arbitrator finding that Hooksett had “just cause” for terminating Dillman.

[¶5] Dillman subsequently brought suit in superior court, alleging that the Union had assigned him its rights under RSA 542:8 (1997) to seek review, modification, and correction of the arbitrator's award. Hooksett, alleging a federal question, removed the case to federal court. It then moved to dismiss the case for lack of subject matter jurisdiction, arguing that Dillman lacked standing under RSA 542:8, either directly or by any purported assignment. Recognizing that “[t]he right to assign the claim of a bargaining unit to an individual has not been determined under New Hampshire law,” the district court certified the above question to this court.

[¶6] The right to seek judicial review of an arbitration award is granted by RSA 542:8, which states, in relevant part:

At any time within one year after the award is made any party to the arbitration may apply to the superior court for an order confirming the award, correcting or modifying the award for plain mistake, or vacating the award for fraud, corruption, or misconduct by the parties or by the arbitrators, or on the ground that the arbitrators have exceeded their powers.

[¶7] We are the final arbiter of the intent of the legislature as expressed in the words of the statute considered as a whole. *Soraghan v. Mt. Cranmore Ski Resort*, 152 N.H. 399, 401, 881 A.2d 693 (2005). We first examine the language of a statute and, where possible, we ascribe the plain and ordinary meanings to the words used. *Id.* Reading RSA 542:8 in this light, we find it plainly provides that being a party to an arbitration is a precondition to applying for a judicial order confirming, correcting, modifying, or vacating the arbitration award. * * * *

[¶8] An exception to this general rule exists when the union has breached its duty of fair representation to the employee. *Bryant*, 288 F.3d at 131; cf. *O'Brien*, 106 N.H. at 257, 209 A.2d 723 (authority of bargaining agent is subject to fiduciary duty of fair representation, and individual employees have the right to question whether union performed that duty in arbitration proceedings). Thus, to have standing to challenge an arbitration proceeding to which a representative union and the employer were the only parties, an individual employee must bring a claim against the union for breach of its duty of fair representation. *Katir v. Columbia University*, 15 F.3d 23, 24-25 (2d Cir.1994); see also *Aloisi*, 321 F.3d at 558. In the present case, the plaintiff has made no such claim; rather, in return for a purported assignment of the union's right to seek judicial review of the arbitrator's decision, he has agreed in writing to surrender his right to bring a claim against the union for breach of the duty of fair representation.

[¶9] The plaintiff argues that the Union's assignment of its rights under RSA 542:8 is subject to no statutory or contractual prohibition. In support of his argument, he cites Restatement (Second) of Contracts § 317 (1979), which states the rule that assignments of contractual rights are valid unless:

- (a) the substitution of a right of the assignee for the right of the assignor would materially change the duty of the obligor, or materially increase the burden or risk imposed on him by his contract, . or
- (b) the assignment is forbidden by statute or is otherwise inoperative on grounds of public policy, or
- (c) assignment is validly precluded by contract.

Restatement (Second) of Contracts § 317(2). Assuming, without deciding, that the rights afforded by RSA 542:8 to parties to arbitration may be deemed contractual in nature, we nonetheless find the plaintiff's argument unpersuasive.

[¶10] We believe, first and foremost, that public policy considerations preclude the assignment of a union's right to seek judicial review of an arbitration decision to aggrieved individual employees. While RSA chapter 542 governs the arbitration of disputes, RSA chapter 273-A, New Hampshire's Public Employee Labor Relations Act, governs the relationship between public employers and their employees, including the determination and certification of exclusive bargaining representatives. RSA chapter 273-A was enacted in 1975 “to foster harmonious and cooperative relations between public employers and their employees and to protect the public by encouraging the orderly and uninterrupted operation of government.” Laws 1975, 490:1; see *Appeal of House Legislative Facilities Subcom.*, 141 N.H. 443, 445-46, 685 A.2d 910 (1996). Specifically, RSA chapter 273-A reflects a legislative purpose of achieving labor peace by requiring collective bargaining between a public employer and an exclusive representative of all employees within a bargaining unit. *Nashua Teachers Union v. Nashua School Dist.*, 142 N.H. 683, 687, 707 A.2d 448 (1998). “Labor peace is enhanced by providing employees with a single voice when bargaining with their employer, and by eliminating the burden on the employer of facing conflicting demands from various employees within a single working unit.” *Id.* at 688, 707 A.2d 448.

[¶11] We believe that the same underlying principle extends to all phases of arbitration proceedings initiated pursuant to a collective bargaining agreement between a public employer and an exclusive bargaining representative. Permitting a union to unilaterally assign its right to demand arbitration under a collective bargaining agreement to an individual employee in exchange for a discharge from its duty of fair representation would, potentially, subject a public employer to a deluge of grievances and arbitration demands of variable, and perhaps negligible, merit. This would bring with it the attendant reality of dealing directly with multiple individual employees without collective representation, plausibly requiring a greater expenditure of public resources than an employer may have contemplated during negotiations with a union. Such a result could materially increase the burden upon a public employer that has negotiated the terms of a collective bargaining agreement in good faith, while leaving the union insulated from liability to the employees it was organized to represent.

[¶12] The plaintiff observes that assignment of a union's right to demand arbitration is distinguishable from assignment of its right to seek judicial review of an arbitrator's award.

Though they may be discrete rights, they are, nonetheless, related to phases of the same process. Permitting a union to assign its right to seek judicial review of an arbitrator's decision pursuant to RSA 542:8 would have no less harmful an effect than permitting the assignment of its right to demand arbitration. We conclude, therefore, that an assignment such as that sought by the plaintiff would contravene the dual public policies, as expressed by the legislature when enacting RSA chapter 273-A, of fostering harmonious and cooperative relations between public employers and their employees and protecting the public by encouraging the orderly and uninterrupted operation of government.

[¶13] Evaluating the Union's purported assignment of its rights under RSA 542:8 to the plaintiff in light of the Restatement (Second) of Contracts § 317(2), as the plaintiff urges us to do, we conclude that such assignment is invalid. As we explained above, it “materially increase[s] the burden or risk imposed” upon Hooksett, Restatement (Second) of Contracts § 317(2)(a), and is “inoperative on grounds of public policy,” *id.* § 317(2)(b).

[¶14] Because we conclude that the assignment of a union's right under RSA 542:8 to apply to seek confirmation, correction, modification, or vacation of an arbitration award to an individual employee is contrary to the public policy articulated by the legislature when enacting the New Hampshire Public Employee Labor Relations Act, RSA chapter 273-A, we answer the certified question in the negative.

Remanded.

Questions:

1. A small, local grocer, Ralph's Grocery Corporation, owned and operated three stores in Midville. Ralph's Grocery Corporation was entirely owned by Ralph. State Farm insured Ralph's Grocery Corporation against fire in the buildings. Ralph decided to sell to HEB, a much larger grocery chain operating throughout the state. In the transaction, Ralph transferred all the shares of Ralph's Grocery Corporation to HEB, which then became the sole shareholder. HEB intended to employ Ralph as manager of the three stores and slowly grow and improve them but otherwise operate them as grocery stores, just as before. A week after the transfer of shares, a fire broke out in one of the new Midville HEB stores. Can State Farm claim that it no longer insures the stores?
2. Would your answer to (1) change if, rather than transferring the shares, Ralph's Grocery Corporation had transferred the stores and insurance policies to HEB?
3. Would your answer to (2) change if Ralph's Grocery Corporation had transferred the stores and policies to WalMart?

If an assignment does occur, how does the obligor of the right assigned find out about it? Why should the obligor perform to the assignee? The law on this issue has changed as

statutes have modified the common law. Please read the case, and then we will introduce some statutes that modify the law.

CONTINENTAL PURCHASING CO., INC. v. VAN RAALTE CO., INC.
N.Y. Supr. Ct., App. Div. (1937), 251 App. Div. 151

EDGECOMB, Justice.

[¶1] This action is brought by the plaintiff, as assignee of Ethel L. Potter, to recover from the Van Raalte Co., Inc., the employer of Mrs. Potter, the sum of nineteen dollars and twenty cents, wages earned by her while employed by the company. The defendant claims exoneration from liability by reason of having paid the amount involved direct to the assignor.

[¶2] It is conceded that on April 21, 1934, Mrs. Potter assigned to the plaintiff all wages, or claims for wages, salary or commission earned, or to be earned, and all claims or demands due her from any person, firm or corporation by whom she was employed, or who might owe her money, as security for the payment of an account which the Steckler Sporting Goods Store had against her, and which account had been purchased by and assigned to the plaintiff.

[¶3] This assignment, having been made prior to July 1, 1934, when section 46 was added to the Personal Property Law by chapter 738 of the laws of that year, is not void by reason of any statutory prohibition relating to wage assignments. Neither is such transfer contrary to public policy. (*Messina v. Continental Purchasing Co.*, 272 N.Y. 125, 126.)

[¶4] While the assignee of a chose in action succeeds to all the rights of the assignor, a debtor is not affected by the assignment until he has notice thereof. If he pays his indebtedness to the assignor in ignorance of the assignment, he is relieved from all liability to the assignee. He may set up against the claim of the assignee any defense acquired prior to notice which would have been available against the assignor had there been no assignment. (*Callanan v. Edwards*, 32 N.Y. 483, 486; *Smith v. Kissel*, 92 App. Div. 235, 241; *affd.*, 181 N.Y. 536.)

[¶5] After notice of the transfer, however, the debtor is put on his guard, and if he pays the assignor any money which, under the assignment, belongs to the assignee, or if he does anything prejudicial to the rights of the latter, he is liable for the resulting damage. (*Lauer v. Dunn*, 115 N.Y. 405, 409; *Brill v. Tuttle*, 81 id. 454, 460; *Weniger v. Fourteenth Street Store*, 191 id. 423, 427; *Heermans v. Ellsworth*, 64 id. 159, 161; *Wheeler v. Wheeler*, 9 Cow. 34; *Wilkins v. Batterman*, 4 Barb. 47; *Briggs v. Dorr*, 19 Johns. 95; *Anderson v. Van Alen*, 12 id. 343.)

[¶6] No set form of notice is required. It is sufficient if such information is given the debtor as will fully inform him that the alleged assignee is the owner of the chose in action, or as will serve to put him on inquiry. (*Countryman v. Boyer*, 3 How. Pr. 386, 388; *Johnson v. Bloodgood*, 1 Johns. Cas. 51, 52; *Anderson v. Van Alen*, 12 Johns. 343, 345; *Dale v. Kimpton*, 46 Vt. 76, 78.)

[¶7] Here the plaintiff protected itself against any bona fide payments made by the debtor to its employee by giving the defendant a written notice of this assignment on September 12, 1934. Seven days later defendant acknowledged receipt of the notice, and suggested that, inasmuch as Mrs. Potter had no other income except her weekly earnings, it would be a great accommodation if a deduction of two dollars per week could be made until the total amount of plaintiff's claim was paid. Plaintiff consented to this adjustment, and withdrew its formal notice. But defendant still knew of the assignment, and on six occasions during the following two months deducted one dollar and fifty cents from Mrs. Potter's wages, and forwarded the same to the plaintiff. This arrangement was discontinued after November twentieth. Plaintiff then gave defendant another formal notice of the assignment, and demanded payment direct to it of the wages due Mrs. Potter, and called attention to the fact that any sums paid to the employee would not relieve the defendant from its obligation to the plaintiff. With full knowledge that the plaintiff was entitled to receive Mrs. Potter's wages, defendant has chosen to pay them to Mrs. Potter. In so doing defendant acted at its peril.

[¶8] Defendant claims immunity from liability in this action because of the fact that neither the original assignment, nor a copy thereof, was ever filed with or exhibited to it. This defense has found favor in the courts below. Such a requirement is not necessary to render a debtor liable to the assignee of a chose in action for the failure to pay him a debt owed to the assignor. Especially is that so where, as here, no such demand or request has ever been made. (*Davenport v. Woodbridge*, 8 Me. 17; *Bean v. Simpson*, 16 id. 49; *North Penn Iron Co. v. International Lithoid Co.*, 217 Penn. St. 538; 66 A. 860.) The cases relied upon by the respondent do not lay down any different rule.

[¶9] Here a full and complete notice of the assignment was given to the defendant, and a demand was made that the assignor's wages be paid to the plaintiff. Defendant never questioned the existence or validity of the transfer, nor asked for any additional proof thereof. On the contrary, it acknowledged its validity, and made six separate payments to the assignee, totaling nine dollars, in reliance thereon. Later it utterly ignored plaintiff's rights in the premises, and paid the assignor her wages as they became due, notwithstanding the fact that it knew this money belonged to the plaintiff. Its only excuse for so doing was the fact that Mrs. Potter was receiving aid from a local charitable organization, and that the matter had been referred to that organization for a decision. Under these circumstances defendant cannot escape its liability to the plaintiff because it paid Mrs. Potter's wages to her.

[¶10] For the reasons stated, we think that the judgments of the City Court of Dunkirk, and of the County Court of Chautauqua county, should be reversed, with costs, and that judgment should be ordered in favor of the plaintiff for the sum of nineteen dollars and twenty cents, with interest thereon from the 21st day of November, 1934.

All concur.

Judgments reversed on the law, with costs in all courts, and judgment directed in favor of the plaintiff in the sum of nineteen dollars and twenty cents, with interest thereon from the 21st day of November, 1934, with costs.

Questions—with answers under the common law:

1. Was it okay to pay Ms. Potter before notice was given? Yes. The obligor is not affected by the assignment until the obligor has notice of the assignment, as [¶4] says.

2. For notice to be effective, must the assignee give the debtor or obligor a copy of the assignment itself? No, as [¶8] says. Notice that the assignment has occurred is all that is necessary.

3. Let's say that you owe Ricks money because Ricks sold you his 1991 Geo Prism. He gave you a month to come up with the money. Three weeks after you take possession of the car (such as it is), you receive an informal letter in the mail from a person named Kaminski saying that Ricks has assigned the debt to him and that payment in a week should be made to Kaminski. Ricks is out of town backpacking somewhere, but he had formerly said to mail the check to him, Ricks. What should you do? This is a difficult problem. Kaminski, if the assignment is real, has no obligation even to give a copy of the assignment, let alone prove that it occurred. Notice has been given in this case. But you understand from Ricks that you were to pay Ricks. You can take some solace from the fact that Kaminski should not have known about the debt unless Ricks told him, but you do not know that an assignment occurred; you only know that Kaminski says one occurred. If you pay Kaminski and no assignment occurred, you will still owe Ricks. If you pay Ricks and the assignment occurred, then you still owe Kaminski. Perhaps you have an honest assignor (if you paid me and I really had assigned, I would send the money back to you so that you could pay Kaminski), but even if you do, the assignment is a hassle. Who has the burden to determine whether the assignment is valid? Under the common law, you do.

4. For whose benefit is the assignment? Certainly not the obligor. At best, the assignment is for the parties to the assignment. So why does the obligor have the obligation to determine whether the assignment is valid? That's a good question.

5. Who is the better bearer of the risk that the assignment is invalid? As between assignee and obligor, the assignee, surely.

6. Should the obligor receive a discharge for paying the assignor? The law says “no” when the payment is made after notice of the assignment.

7. Does the assignor warrant that the obligor is solvent? No, not by default. This is a risk that the assignee takes.

Now read—

Uniform Commercial Code § 9-406(a)-(d)

. . . and consider the same questions again.

1. If this statute were the law, was it okay to pay Ms. Potter before notice was given?

2. For notice to be effective, must the assignee give the debtor or obligor a copy of the assignment itself? What does the statute add to the common law to account for the obligor’s need to know the details of the assignment?

3. Let’s say that you owe Ricks money because Ricks sold you his 1991 Geo Prism. He gave you a month to come up with the money. Three weeks after you take possession of the car (such as it is), you receive an informal letter in the mail from a person named Kaminski saying that Ricks has assigned the debt to him and that payment in a week should be made to Kaminski. Ricks is out of town backpacking somewhere, but he had formerly said to mail the check to him, Ricks. What should you do? How does the statute resolve this problem?

4. For whose benefit is the assignment? Who is the better bearer of the risk that the assignment is invalid? How does the statute place the burden with the benefit?

Uniform Commercial Code §§ 9-403(b), 9-404(a); 16 C.F.R. 433.2

PROBLEM 17: I buy a used 1972 Nova from Cheatum’s Used Cars in exchange for a promissory note and security agreement (that the car serve as collateral). Cheatum’s immediately sells my financing account to Steele Finance Company. The day I buy the car, I only drive it home, but the next day I try to drive it some more. It doesn’t work. I open the air filter and find it full of sawdust. The car obviously needs major repairs. To make the problem easy, let’s suppose that there were no warranty disclaimers and that I can take the car back to Cheatum’s. They agree to take the car, but they say that they’ve already sold my account to Steele and I will have to talk to Steele about getting my money back. This is news to me, but Steele did take an assignment of my account.

1. Will I have to pay Steele for the car I no longer own?

2. Let's suppose that rather than try to give the car back, I ask for a discount. Cheatum's and I agree on a discount, sign a document to that effect, and I tow the car back home. Is Steele bound by the modification? Did I ever agree to deal with Steele?

Marco RUMBIN v. UTICA MUT. INS. CO.
Conn. (2001), 757 A.2d 526

[¶1] * * * * The record reveals the following facts. In April, 1998, the plaintiff and Utica Mutual entered into a structured settlement agreement to resolve a personal injury claim. Pursuant to that settlement agreement, the plaintiff was to receive from Utica Mutual a lump sum payment, followed by a series of periodic payments over the next fifteen years. The structured portion of the settlement was funded by the annuity contract issued by Safeco. The annuity contract provided under its "Assignment" provision that "[n]o payment under this annuity contract may be . . . assigned . . . in any manner by the [plaintiff]",*

[¶2] Approximately six months after the execution of the settlement agreement and the issuance of the annuity, the plaintiff had become unemployed and faced a mortgage foreclosure action against his home, where he lived with his family. In order to resolve his financial troubles, the plaintiff decided to sell his right to the annuity payments. In November, 1998, he filed a declaratory judgment action seeking court approval, pursuant to No. 98-238, § 1, of the 1998 Public Acts (P.A. 98-238), now codified at § 52-225f [requiring court approval of the transfer of structured settlement rights], to transfer his right to the remaining annuity payments to Wentworth in exchange for a lump sum payment and other consideration. Safeco objected to the assignment, claiming that because the annuity contract contained an antiassignment provision, P.A. 98-238 was inapplicable. Utica Mutual neither appeared at that hearing, nor provided an explanation for its failure to appear, and the trial court issued an order of default for failure to appear against Utica Mutual.

[¶3] The trial court, after a hearing, concluded that P.A. 98-238 invalidated antiassignment provisions and allowed payees to transfer their rights to future payments under structured settlement agreements when the statutory requirements were met. The trial court further found that, pursuant to P.A. 98-238, the proposed sale of the annuity payments was in the best interests of the plaintiff, and was fair and reasonable to all interested parties. Accordingly, the court rejected Safeco's claim concerning the applicability of the antiassignment provision, and rendered judgment approving the transfer of the plaintiff's annuity payments to Wentworth. Safeco appealed from the trial court's judgment to the Appellate Court, and we transferred the case to this court * * * . * * * *

* Under the terms of the settlement agreement, the plaintiff was entitled to receive \$52,000 within thirty days of its execution, thirty semiannual payments of \$1323.09 beginning on March 6, 1999, and a final lump sum payment of \$44,000 on March 6, 2014.

II

[¶4] The primary issue raised by this case is whether, under Connecticut common law, an antiassignment provision in an annuity contract invalidates the plaintiff payee's transfer of his right to future payments under the annuity to a third party. We conclude, in accordance with case law and § 322 of the Restatement (Second) of Contracts, that the antiassignment provision at issue here does not render the assignment of the annuity ineffective, but, instead, gives the annuity issuer, Safeco, the right to recover damages for breach of the antiassignment provision.

[¶5] Although we previously have addressed the issue of the validity of contractual provisions prohibiting the assignment of contractual rights; see *Lewin & Sons, Inc. v. Herman*, 143 Conn. 146, 149, 120 A.2d 423 (1956) (upholding validity of contractual provision that prohibited assignment without consent); the law of contracts has changed considerably since our earlier decision. Accordingly, we now reexamine the basic legal principles regarding contractual antiassignment provisions.

[¶6] Our analysis of the effect of the antiassignment provision begins by emphasizing that the modern approach to contracts rejects traditional common-law restrictions on the alienability of contract rights in favor of free assignability of contracts. See 3 Restatement (Second), Contracts § 317, p. 15 (1981) (“[a] contractual right can be assigned”); J. Murray, Jr., *Contracts* (3d Ed. 1990) (“the modern view is that contract rights should be freely assignable”); 3 E. Farnsworth, *Contracts* (2d Ed. 1998) § 11.2, p. 61 (“[t]oday most contract rights are freely transferable”). Common-law restrictions on assignment were abandoned when courts recognized the necessity of permitting the transfer of contract rights. “The force[s] of human convenience and business practice [were] too strong for the common-law doctrine that [intangible contract rights] are not assignable.” (Internal quotation marks omitted.) J. Murray, Jr., *supra*, § 135, p. 791. “If the law were otherwise, our modern credit economy could not exist.” 3 E. Farnsworth, *supra*, § 11.2, p. 61. As a result, an assignor typically can transfer his contractual right to receive future payments to an assignee. * * * *

[¶7] The parties to a contract can include express language to limit assignment and courts generally uphold these contractual antiassignment clauses. See 3 Restatement (Second), *supra*, § 317, p. 15 (“[a] contractual right can be assigned unless . . . assignment is validly precluded by contract”); 3 E. Farnsworth, *supra*, § 11.4, pp. 82 (“most courts have upheld [terms prohibiting assignment] as precluding effective assignment”). Given the importance of free assignability, however, antiassignment clauses are construed narrowly whenever possible. See 3 E. Farnsworth, *supra*, § 11.4, pp. 82–83.

[¶8] In interpreting antiassignment clauses, the majority of jurisdictions now distinguish between the assignor's “right” to assign and the “power” to assign (modern approach). For example, in *Bel-Ray Co. v. Chemrite (Pty.) Ltd.*, 181 F.3d 435, 442 (3d Cir. 1999), the United States Court of Appeals for the Third Circuit recognized that numerous jurisdictions

followed the general rule “that contractual provisions limiting or prohibiting assignments operate only to limit [the] parties’ right to assign the contract, but not their power to do so, unless the parties manifest an intent to the contrary with specificity.” (Emphasis added.) The court concluded, however, that the “assignment clauses [did] not contain the requisite clear language to limit [the] ‘power’ to assign” and, therefore, held the assignment valid and enforceable. *Id.*, 443. The court acknowledged that contracting parties could limit the power to assign by including an “assignment provision [that] generally state[s] that nonconforming assignments (i) shall be ‘void’ or ‘invalid,’ or (ii) that the assignee shall acquire no rights or the nonassigning party shall not recognize any such assignment.” *Id.*, 442. Without such express contractual language, however, “the provision limiting or prohibiting assignments will be interpreted merely as a covenant not to assign Breach of such a covenant may render the assigning party liable in damages to the non-assigning party. The assignment, however, remains valid and enforceable against both the assignor and the assignee.” *Id.*

[¶9] Many other courts similarly have held that an antiassignment provision that limits the right to assign does not void an assignment between an assignor and assignee unless there is also an express provision limiting the power to assign or a provision voiding the assignment itself. See, e.g., *Pravin Banker Associates, Ltd. v. Banco Popular Del Peru*, 109 F.3d 850, 856 (2d Cir. 1997) (“[t]o reveal the intent necessary to preclude the power to assign, or cause an assignment violative of contractual provisions to be wholly void, [a contractual] clause must contain express provisions that any assignment shall be void or invalid if not made in a certain specified way”); *Cedar Point Apartments, Ltd. v. Cedar Point Investment Corp.*, 693 F.2d 748, 754 (8th Cir. 1982) (concluding that “[m]erely the ‘right to assign,’ not the power to assign, [was] limited by the express language of the [antiassignment] clause. No intent is thereby revealed to avoid an assignment not meeting the restrictions.”); * * * *Pro Cardiac Pronto Socorro Cardiologica, S.A. v. Trussell*, 863 F. Supp. 135, 138 (S.D.N.Y. 1994) (“assignments are enforceable unless expressly made void”); * * * [very long string cite omitted]. Thus, the modern approach finds support in the majority of jurisdictions.

[¶10] The modern approach, however, is not adopted by some courts, which uphold antiassignment clauses regardless of whether the parties have included contractual language that expressly limits the power to assign or expressly invalidates the assignment itself. We agree with these courts that contracting parties can exercise their freedom to contract to overcome free alienability when they include the appropriate contractual language. See *Parrish Chiropractic Centers, P.C. v. Progressive Casualty Ins. Co.*, 874 P.2d 1049, 1054–55 (Colo. 1994) (“The policy supporting free alienability is not such an absolute one that it must override a contract provision prohibiting assignment in a specific context. . . . To hold otherwise would be to force [the obligor] to deal with parties with whom it has not contracted, regardless of . . . express contractual provision” [Citations omitted; internal quotation marks omitted]); *Portland Electric & Plumbing Co. v. Vancouver*, 29 Wash. App. 292, 295, 627 P.2d 1350 (1981) (“The primary purpose of clauses prohibiting the assignment of contract rights without a contracting party’s

permission is to protect him in selecting the persons with whom he deals. . . . When a contract prohibits assignment in ‘very specific’ and ‘unmistakable terms’ the assignment will be void against the obligor.” [Citation omitted.]). We disagree, however, with these courts that the antiassignment provisions in these cases contained the necessary contractual language. * * * * These courts ignore the rule adopted by the majority of jurisdictions, which requires that in order to invalidate the assignment, the parties must include in their antiassignment provision language that specifically limits the power to assign or invalidates the assignment itself.

[¶11] The modern approach offers the advantage of free assignability together with full protection for any obligor who actually suffers damages as a result of an assignment. An assignor who breaches a contractual provision limiting his or her right to assign will be liable for any damages that result from that assignment. See, e.g., *Bel-Ray Co. v. Chemrite (Pty.) Ltd.*, supra, 181 F.3d 442 (“the provision limiting or prohibiting assignments will be interpreted merely as a covenant not to assign Breach of such a covenant may render the assigning party liable in damages to the non-assigning party. The assignment, however, remains valid and enforceable”); * * * [very long string cite omitted]. Thus, courts in numerous jurisdictions have recognized the evenhandedness of the modern approach.

[¶12] This approach is also adopted in the Restatement (Second) of Contracts. Section 322 (2) (b) of the Restatement (Second), supra, provides that the general rule is “[a] contract term prohibiting assignment of rights under the contract, unless a different intention is manifested . . . (b) gives the obligor a right to damages for breach of the terms forbidding assignment but does not render the assignment ineffective” See, e.g., *Bel-Ray Co. v. Chemrite (Pty.) Ltd.*, supra, 181 F.3d 442; * * * . In the present case, the annuity contract provided that “[n]o payment under this annuity contract may be . . . assigned” by the plaintiff. This antiassignment provision limited the plaintiff’s right to assign, but not his power to do so. The provision did not contain any express language to limit the power to assign or to void the assignment itself. Therefore, in accordance with the modern approach, we conclude that the plaintiff’s assignment to Wentworth is valid and enforceable despite the plaintiff’s breach of the contract’s antiassignment provision. We further conclude, however, that Safeco is free to sue for any damages that it might sustain as a result of the assignment by bringing an action for breach of contract against the plaintiff as assignor. * * * *

[¶13] The modern approach thus serves the dual objectives of free assignability of contracts together with full compensation for any actual damages that might result from an assignment made in breach of an antiassignment provision.

The judgment is affirmed.

In this opinion BORDEN and PALMER, Js., concurred.

Questions:

1. Do you suppose that Utica wrote the anti-assignment clause into the contract in order to make sure that, if assignment occurs, it would receive a damage award?
2. Why do you suppose Safeco, the liability insurer, was so bothered by the assignment? The court related that Safeco made rumblings about losing a tax-favored status, but the supreme court affirmed, “At the trial court hearing, Safeco did not show any actual damages resulting from the assignment.” *Id.* at 277 n.11. Does this finding affect how you see the justice of the “modern” approach?
3. What policies support a broader interpretation of anti-assignment clauses? In *Condo v. Conners*, 266 P.3d 1110 (Colo. 2011) (en banc), Thomas Banner was a member of Hut at Avon, LLC. The operating agreement of Hut contained an anti-assignment clause: “a Member shall not sell, assign, pledge or otherwise transfer any portion of its interest in” the LLC “without the prior written approval of all of the Members”; and if “at any time any Member proposes to sell, assign or otherwise dispose of all or any part of its interest in the [LLC], such Member . . . shall first obtain written approval of all of the Members to such transfer.” *Id.* at 1113. As part of Banner and Elizabeth Condo’s divorce settlement, Banner agreed to assign to Condo his right to receive distributions from Hut and his right to vote as a LLC member. Banner sought the approval of the other LLC members, but they refused. Banner then purported to assign the right to distributions and voting to Condo without that approval. When the other members objected and offered in response to buy out Banner, Banner sold to them. Condo then sued for tortious interference with contract, and this claim depended on her having the rights Banner purported to assign to her. Would the rule in *Rumbin* allow Banner’s assignment to Condo to be effective?

In *Condo*, the court rejected the *Rumbin* rule and Condo’s claim. The court explained:

[¶1] We first note that the court of appeals resolved this issue by looking to what it considered to be our application of the classical approach in *Parrish Chiropractic Centers, P.C. v. Progressive Casualty Insurance Co.*, 874 P.2d 1049, 1051 (Colo. 1994), and extending this principle to the context of an anti-assignment clause in an LLC operating agreement. Condo, slip op. at 13-14. Under the classical approach, an assignment made in violation of an express anti-assignment clause is void ab initio because the assignor is powerless to make a nonconforming transfer. *See id.*

[¶2] Now, Condo urges us to depart from *Parrish Chiropractic* and adhere to the modern approach as set forth in *Rumbin v. Utica Mutual Insurance Co.*, 757 A.2d 526 (Conn. 2000). Under the modern approach, an anti-assignment clause creates a duty by which a party is contractually obligated to refrain from making a nonconforming assignment, but does not restrict the power of a member to

nevertheless do so. *Id.* at 530-31. Instead of classifying a nonconforming assignment as void, the modern approach treats this unlawful act as a breach of the duty not to assign, which can then be enforced by the other party or parties to the contract through a breach of contract action. *Id.* As adopted in *Rumbin*, the modern approach allows for parties to contractually restrict the power — again, as opposed to the right — to assign, but such a clause will only render the parties powerless to assign when it expressly states that any nonconforming assignment is “void” or “invalid.” *See id.* at 531-33 (collecting cases that apply the modern approach); *see also Travertine Corp. v. Lexington-Silverwood*, 683 N.W.2d 267, 272 (Minn. 2004) (adopting the classical approach, but characterizing the exception to the modern approach as the “magic words” requirement) [hereinafter, the “strict ‘magic words’ approach”].

The Restatement, however, does not adopt the strict “magic words” approach, and instead states that whether an anti-assignment clause merely creates a duty not to assign turns on the language used and the context in which the contract is made. Restatement (Second) of Contracts § 322(2)(a) (1981) (noting that the general presumption that an assignment in violation of an anti-assignment clause is merely a breach of the contract and is therefore still legally effective, can be overcome if “a different intention is manifested” in the anti-assignment clause); *id.* cmt.c (explaining that it “depends on all the circumstances” whether the nonassigning contract parties are bound to perform any rights that are assigned in violation of the terms of an anti-assignment clause). Thus, although the Restatement is similar to *Rumbin* in that it creates a presumption in favor of treating an anti-assignment clause as a duty not to assign, given specific language in an anti-assignment clause and under the appropriate circumstances, it allows that an anti-assignment clause may render the parties powerless to assign, even in the absence of “magic words.”

Applying our previous holding in *Parrish Chiropractic* and considering the rationale underlying the Restatement approach, we hold that the Operating Agreement rendered the parties powerless to assign any portion of the membership interest without the consent of all other members. Two of the rationales we applied in *Parrish Chiropractic* are pertinent to our resolution of the present matter. First, we highlighted the strong public policy in favor of freedom of contract — that is, the ability of a party to contractually restrict the ability of other parties to assign their rights and/or duties. *Parrish Chiropractic*, 874 P.2d at 1054. Second, we emphasized “the corollary right of the [nonassigning party] to deal only with whom it contracted.” *Id.* at 1054-55. Thus, we applied the classical approach in *Parrish Chiropractic* to afford contracting parties the maximum flexibility to shape their contract within the confines of the law, while simultaneously allowing for the option of increased predictability and stability in contractual relations through the use of an anti-assignment clause. *See id.* * * * *

* * * * Unlike the court of appeals, however, we do not treat *Parrish Chiropractic* a blanket rejection of the modern approach to assignments as adopted by the Restatement (Second) of Contracts. See *Condo*, slip op. at 13. Rather, in light of the Restatement's express limitation that the application of the modern approach is necessarily dependent on the circumstances and the express terms of the operating agreement, we narrowly hold that the strict "magic words" approach is inapplicable to the present case.

Condo, 266 P.3d at 1117-18. Can you square *Condo* and *Rumbin*?

B. Delegation

SALLY BEAUTY COMPANY, INC. v. NEXXUS PRODUCTS COMPANY, INC.
7th Cir. U.S. Ct. App. (1986), 801 F.2d 1001

CUDAHY, Circuit Judge.

[¶1] Nexxus Products Company ("Nexxus") entered into a contract with Best Barber & Beauty Supply Company, Inc. ("Best"), under which Best would be the exclusive distributor of Nexxus hair care products to barbers and hair stylists throughout most of Texas. When Best was acquired by and merged into Sally Beauty Company, Inc. ("Sally Beauty"), Nexxus cancelled the agreement. Sally Beauty is a wholly-owned subsidiary of Alberto-Culver Company ("Alberto-Culver"), a major manufacturer of hair care products and a competitor of Nexxus'. Sally Beauty claims that Nexxus breached the contract by cancelling; Nexxus asserts by way of defense that the contract was not assignable or, in the alternative, not assignable to Sally Beauty. The district court granted Nexxus' motion for summary judgment, ruling that the contract was one for personal services and therefore not assignable. We affirm on a different theory—that this contract could not be assigned to the wholly-owned subsidiary of a direct competitor under section 2-210 of the Uniform Commercial Code.

I.

[¶2] Only the basic facts are undisputed and they are as follows. Prior to its merger with Sally Beauty, Best was a Texas corporation in the business of distributing beauty and hair care products to retail stores, barber shops and beauty salons throughout Texas. Between March and July 1979, Mark Reichel, Best's president, negotiated with Stephen Redding, Nexxus' vice-president, over a possible distribution agreement between Best and Nexxus. Nexxus, founded in 1979, is a California corporation that formulates and markets hair care products. Nexxus does not market its products to retail stores, preferring to sell them to independent distributors for resale to barbers and beauticians. On August 2, 1979, Nexxus

executed a distributorship agreement with Best, in the form of a July 24, 1979 letter from Reichek, for Best, to Redding, for Nexxus:

Dear Steve:

It was a pleasure meeting with you and discussing the distribution of Nexus Products. The line is very exciting and we feel we can do a substantial job with it — especially as the exclusive distributor in Texas (except El Paso).

If I understand the pricing structure correctly, we would pay \$1.50 for an item that retails for \$5.00 (less 50%, less 40% off retail), and Nexus will pay the freight charges regardless of order size. This approach to pricing will enable us to price the items in the line in such a way that they will be attractive and profitable to the salons.

Your offer of assistance in promoting the line seems to be designed to simplify the introduction of Nexus Products into the Texas market. It indicates a sincere desire on your part to assist your distributors. By your agreeing to underwrite the cost of training and maintaining a qualified technician in our territory, we should be able to introduce the line from a position of strength. I am sure you will let us know at least 90 days in advance should you want to change this arrangement.

By offering to provide us with the support necessary to conduct an annual seminar (ie. mailers, guest artist [sic]) at your expense, we should be able to reenforce our position with Nexus users and introduce the product line to new customers in a professional manner.

To satisfy your requirement of assured payment for merchandise received, each of our purchase orders will be accompanied by a Letter of Credit that will become negotiable when we receive the merchandise. I am sure you will agree that this arrangement is fairest for everybody concerned.

While we feel confident that we can do an outstanding job with the Nexus line and that the volume we generate will adequately compensate you for your continued support, it is usually best to have an understanding should we no longer be distributing Nexus Products — either by our desire or your request. Based on our discussions, cancellation or termination of Best Barber & Beauty Supply Co., Inc. as a distributor can only take place on the anniversary date of our original appointment as a distributor — and then only with 120 days prior notice. If Nexus terminates us, Nexus will buy back all of our inventory at cost and will pay the freight charges on the returned merchandise.

Steve, we feel that the Nexus line is exciting and very promotable. With the program outlined in this letter, we feel it can be mutually profitable and look forward to a long and successful business relationship. If you agree that this letter contains the details of our understanding regarding the distribution of Nexus Products, please sign the acknowledgment below and return one copy of this letter to me.

Very truly yours, /s/ Mark E. Reichek President

Acknowledged /s/ Stephen Redding Date 8/2/79.

Appellant's Appendix at 2-3.

[¶3] In July 1981 Sally Beauty acquired Best in a stock purchase transaction and Best was merged into Sally Beauty, which succeeded to Best's rights and interests in all of Best's contracts. Sally Beauty, a Delaware corporation with its principal place of business in Texas, is a wholly-owned subsidiary of Alberto-Culver. Sally Beauty, like Best, is a distributor of hair care and beauty products to retail stores and hair styling salons. Alberto-Culver is a major manufacturer of hair care products and, thus, is a direct competitor of Nexxus in the hair care market.*

[¶4] Shortly after the merger, Redding met with Michael Renzulli, president of Sally Beauty, to discuss the Nexxus distribution agreement. After the meeting, Redding wrote Renzulli a letter stating that Nexxus would not allow Sally Beauty, a wholly-owned subsidiary of a direct competitor, to distribute Nexxus products:

As we discussed in New Orleans, we have great reservations about allowing our NEXXUS Products to be distributed by a company which is, in essence, a direct competitor. We appreciate your argument of autonomy for your business, but the fact remains that you are totally owned by Alberto-Culver.

Since we see no way of justifying this conflict, we cannot allow our products to be distributed by Sally Beauty Company.

Appellant's Appendix at 475.

[¶5] In August 1983 Sally Beauty commenced this action by filing a complaint in the Northern District of Illinois, claiming that Nexxus had violated the federal antitrust laws and breached the distribution agreement. In August 1984 Nexxus filed a counterclaim alleging violations of the Lanham Act, the Racketeer Influenced and Corrupt Organizations Act ("RICO") and the unfair competition laws of North Carolina, Tennessee and unidentified "other states." On October 22, 1984 Sally Beauty filed a motion to dismiss the counterclaims arising under RICO and "other states' law." Nexxus filed a motion for summary judgment on the breach of contract claim the next day.

[¶6] The district court ruled on these motions in a Memorandum Opinion and Order dated January 31, 1985. It granted Sally's motion to dismiss the two counterclaims and also granted Nexxus' motion for summary judgment. In May 1985 it dismissed the remaining claims and counterclaims (pursuant to stipulation by the parties) and directed the entry of an appealable final judgment on the breach of contract claim.

* The appellant does not appear to dispute the proposition that Alberto-Culver is Nexxus' direct competitor, see Reply Brief at 8-10; rather it disagrees only with Nexxus' contention that performance by Sally Beauty would necessarily be unacceptable. See *infra*.

II.

[¶7] Sally Beauty's breach of contract claim alleges that by acquiring Best, Sally Beauty succeeded to all of Best's rights and obligations under the distribution agreement. It further alleges that Nexxus breached the agreement by failing to give Sally Beauty 120 days notice prior to terminating the agreement and by terminating it on other than an anniversary date of its formation. Complaint, Count III, Appellant's Appendix at 54-55. Nexxus, in its motion for summary judgment, argued that the distribution agreement it entered into with Best was a contract for personal services, based upon a relationship of personal trust and confidence between Reichel and the Redding family. As such, the contract could not be assigned to Sally without Nexxus' consent.

[¶8] In opposing this motion Sally Beauty argued that the contract was freely assignable because (1) it was between two corporations, not two individuals and (2) the character of the performance would not be altered by the substitution of Sally Beauty for Best. It also argued that "the Distribution Agreement is nothing more than a simple, non-exclusive contract for the distribution of goods, the successful performance of which is in no way dependent upon any particular personality, individual skill or confidential relationship." Appellant's Appendix at 119.

[¶9] In ruling on this motion, the district court framed the issue before it as "whether the contract at issue here between Best and Nexxus was of a personal nature such that it was not assignable without Nexxus' consent." It ruled:

The court is convinced, based upon the nature of the contract and the circumstances surrounding its formation, that the contract at issue here was of such a nature that it was not assignable without Nexxus's consent. First, the very nature of the contract itself suggests its personal character. A distribution agreement is a contract whereby a manufacturer gives another party the right to distribute its products. It is clearly a contract for the performance of a service. In the court's view, the mere selection by a manufacturer of a party to distribute its goods presupposes a reliance and confidence by the manufacturer on the integrity and abilities of the other party. . . . In addition, in this case the circumstances surrounding the contract's formation support the conclusion that the agreement was not simply an ordinary commercial contract but was one which was based upon a relationship of personal trust and confidence between the parties. Specifically, Stephen Redding, Nexxus's vice-president, travelled to Texas and met with Best's president personally for several days before making the decision to award the Texas distributorship to Best. Best itself had been in the hair care business for 40 years and its president Mark Reichel had extensive experience in the industry. It is reasonable to conclude that Stephen Redding and Nexxus would want its distributor to be experienced and knowledgeable in the hair care field and that the selection of Best was based upon personal factors such as these.

Memorandum Opinion and Order at 56 (citation omitted). The district court also rejected the contention that the character of performance would not be altered by a substitution of

Sally Beauty for Best: "Unlike Best, Sally Beauty is a subsidiary of one of Nexxus' direct competitors. This is a significant distinction and in the court's view, it raises serious questions regarding Sally Beauty's ability to perform the distribution agreement in the same manner as Best." *Id.* at 7.

[¶10] We cannot affirm this summary judgment on the grounds relied on by the district court. Under Fed.R.Civ.P. 56(c) summary judgment may be granted only where there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. The burden on the movant is stringent: "all doubts as to the existence of material fact must be resolved against the movant." *Moore v. Marketplace Restaurant, Inc.*, 754 F.2d 1336, 1339 (7th Cir.1985), quoting *Dreher v. Sielaff*, 636 F.2d 1141, 1143 n. 4 (7th Cir.1980). Nexxus did not meet its burden on the question of the parties' reasons for entering into this agreement. Although it might be "reasonable to conclude" that Best and Nexxus had based their agreement on "a relationship of personal trust and confidence," and that Reichek's participation was considered essential to Best's performance, this is a finding of fact. See *Phillips v. Oil, Inc.*, 104 S.W.2d 576, 579 (Tex.Civ.App.1937, writ ref'd n.r.e.) (question whether contract was entered into because of parties' "personal confidence and trust" is for the determination of trier of fact). Since the parties submitted conflicting affidavits on this question,* the district court erred in relying on Nexxus' view as representing undisputed fact in ruling on this summary judgment motion. See *Cedillo v. Local 1, International Association of Bridge & Structural Iron Workers*, 603 F.2d 7, 11 (7th Cir.1979) ("questions of motive and intent are particularly inappropriate for summary adjudication").†

[¶11] We may affirm this summary judgment, however, on a different ground if it finds support in the record. *United States v. Winthrop Towers*, 628 F.2d 1028, 1037 (7th Cir.1980). Sally Beauty contends that the distribution agreement is freely assignable

* Reichek stated the following in an affidavit submitted in support of Sally Beauty's Memorandum in Opposition to Nexxus' Motion for Summary Judgment:

At no time prior to the execution of the Distribution Agreement did Steve Redding tell me that he was relying upon my personal peculiar tastes and ability in making his decision to award a Nexxus distributorship to Best. Moreover, I never understood that Steve Redding was relying upon my skill and ability in particular in choosing Best as a distributor.

I never considered the Distribution Agreement to be a personal service contract between me and Nexxus or Stephen Redding. I always considered the Distribution Agreement to be between Best and Nexxus as expressly provided in the Distribution Agreement which was written by my brother and me. At all times I conducted business with Nexxus on behalf of Best and not on my own behalf. In that connection, when I sent correspondence to Nexxus, I invariably signed it as president of Best.

Neither Stephen Redding nor any other Nexxus employee ever told me that Nexxus was relying on my personal financial integrity in executing the Distribution Agreement or in shipping Nexxus products to Best. . . .

Affidavit of Mark Reichek, ¶¶ 19-21, Appellant's Appendix at 189-190.

† It is also possible to read the district court's decision as ruling that all distribution agreements are as a matter of law personal services contracts and therefore nonassignable. For the reasons explained *infra*, we do not believe that this is an accurate statement of the law.

because it is governed by the provisions of the Uniform Commercial Code (the "UCC" or the "Code"), as adopted in Texas.* Appellants' Brief at 46-47. We agree with Sally that the provisions of the UCC govern this contract and for that reason hold that the assignment of the contract by Best to Sally Beauty was barred by the UCC rules on delegation of performance, UCC § 2-210(1), Tex.Bus & Com.Code Ann. § 2-210(a) (Vernon 1968).

III.

[¶12] The UCC codifies the law of contracts applicable to "transactions in goods." UCC § 2-102, Tex.Bus. & Com.Code Ann. § 2-102 (Vernon 1968). Texas applies the "dominant factor" test to determine whether the UCC applies to a given contract or transaction: was the essence of or dominant factor in the formation of the contract the provision of goods or services? * * * * No Texas case addresses whether a distribution agreement is a contract for the sale of goods, but the rule in the majority of jurisdictions is that distributorships (both exclusive and non-exclusive) are to be treated as sale of goods contracts under the UCC. * * * * [Long list of citations omitted.]

[¶13] Several of these courts note that "a distributorship agreement is more involved than a typical sales contract," *Quality Performance Lines*, 609 P.2d at 1342, but apply the UCC nonetheless because the sales aspect in such a contract is predominant. See *Corenswet*, 594 F.2d at 134 ("Although most distributorship agreements, like franchise agreements, are more than sales contracts, the courts have not hesitated to apply the Uniform Commercial Code to cases involving such agreements."); *Zapatha*, 408 N.E.2d at 1374-75 n. 8 (courts have applied UCC to distribution agreements because the sales aspect is predominant). This is true of the contract at issue here (as embodied in the July 24, 1979 letter from Reichek to Redding). Most of the agreed-to terms deal with Nexxus' sale of its hair care products to Best. We are confident that a Texas court would find the sales aspect of this contract dominant and apply the majority rule that such a distributorship is a contract for "goods" under the UCC.

IV.

[¶14] The fact that this contract is considered a contract for the sale of goods and not for the provision of a service does not, as Sally Beauty suggests, mean that it is freely assignable in all circumstances. The delegation of performance under a sales contract (whether in conjunction with an assignment of rights, as here, or not) is governed by UCC section 2-210(1), Tex.Bus. & Com.Code § 2-210(a) (Vernon 1968). The UCC recognizes that in many cases an obligor will find it convenient or even necessary to relieve himself of the duty of performance under a contract, see Official Comment 1, UCC § 2-210 ("[T]his section recognizes both delegation of performance and assignability as normal and permissible incidents of a contract for the sale of goods."). The Code therefore sanctions

* The parties agree that the contract is governed by the law of Texas. See *Zlotnick v. MacArthur*, 550 F. Supp. 371, 373-74 (N.D.Ill.1982).

delegation except where the delegated performance would be unsatisfactory to the obligee: "A party may perform his duty through a delegate unless otherwise agreed to or unless the other party has a substantial interest in having his original promisor perform or control the acts required by the contract." UCC § 2-210(1), Tex.Bus. & Com.Code Ann. § 2-210(a) (Vernon 1968). Consideration is given to balancing the policies of free alienability of commercial contracts and protecting the obligee from having to accept a bargain he did not contract for.

[¶15] We are concerned here with the delegation of Best's duty of performance under the distribution agreement, as Nexxus terminated the agreement because it did not wish to accept Sally Beauty's substituted performance.* Only one Texas case has construed section 2-210 in the context of a party's delegation of performance under an executory contract. In *McKinnie v. Milford*, 597 S.W.2d 953 (Tex.Civ.App.1980, writ ref'd, n.r.e.), the court held that nothing in the Texas Business and Commercial Code prevented the seller of a horse from delegating to the buyer a pre-existing contractual duty to make the horse available to a third party for breeding. "[I]t is clear that Milford [the third party] had no particular interest in not allowing Stewart [the seller] to delegate the duties required by the contract. Milford was only interested in getting his two breedings per year, and such performance could only be obtained from McKinnie [the buyer] after he bought the horse from Stewart." *Id.* at 957. In *McKinnie*, the Texas court recognized and applied the UCC rule that bars delegation of duties if there is some reason why the non-assigning party would find performance by a delegate a substantially different thing than what he had bargained for.

[¶16] In the exclusive distribution agreement before us, Nexxus had contracted for Best's "best efforts" in promoting the sale of Nexxus products in Texas. UCC § 2-306(2), Tex.Bus. & Com.Code Ann. § 2-306(b) (Vernon 1968), states that "[a] lawful agreement by either buyer or seller for exclusive dealing in the kind of goods concerned imposes unless otherwise agreed an obligation by the seller to use best efforts to supply the goods and by the buyer to use best efforts to promote their sale." This implied promise on Best's part was the consideration for Nexxus' promise to refrain from supplying any other distributors within Best's exclusive area. See Official Comment 5, UCC § 2-306. It was this contractual undertaking which Nexxus refused to see performed by Sally.

[¶17] In ruling on Nexxus' motion for summary judgment, the district court noted: "Unlike Best, Sally Beauty is a subsidiary of one of Nexxus' direct competitors. This is a significant distinction and in the court's view, it raises serious questions regarding Sally Beauty's ability to perform the distribution agreement in the same manner as Best."

* If this contract is assignable, Sally Beauty would also, of course, succeed to Best's rights under the distribution agreement. But the fact situation before us must be distinguished from the assignment of contract rights that are no longer executory (e.g., the right to damages for breach or the right to payment of an account), which is considered in UCC section 2-210(2), Tex.Bus. & Com.Code Ann. § 2-210(b) (Vernon 1968), and in several of the authorities relied on by appellants. The policies underlying these two situations are different and, generally, the UCC favors assignment more strongly in the latter. See UCC § 2-210(2) (non-executory rights assignable even if agreement states otherwise).

Memorandum Opinion and Order at 7. In *Berliner Foods Corp. v. Pillsbury Co.*, 633 F. Supp. 557 (D.Md.1986), the court stated the same reservation more strongly on similar facts. Berliner was an exclusive distributor of Haagen-Dazs ice cream when it was sold to Breyer's, manufacturer of a competing ice cream line. Pillsbury Co., manufacturer of Haagen-Dazs, terminated the distributorship and Berliner sued. The court noted, while weighing the factors for and against a preliminary injunction, that "it defies common sense to require a manufacturer to leave the distribution of its products to a distributor under the control of a competitor or potential competitor." *Id.* at 559-60.* We agree with these assessments and hold that Sally Beauty's position as a wholly-owned subsidiary of Alberto-Culver is sufficient to bar the delegation of Best's duties under the agreement.

[¶18] We do not believe that our holding will work the mischief with our national economy that the appellants predict. We hold merely that the duty of performance under an exclusive distributorship may not be delegated to a competitor in the market place—or the wholly-owned subsidiary of a competitor—without the obligee's consent. We believe that such a rule is consonant with the policies behind section 2-210, which is concerned with preserving the bargain the obligee has struck. Nexxus should not be required to accept the "best efforts" of Sally Beauty when those efforts are subject to the control of Alberto-Culver. It is entirely reasonable that Nexxus should conclude that this performance would be a different thing than what it had bargained for. At oral argument, Sally Beauty argued that the case should go to trial to allow it to demonstrate that it could and would perform the contract as impartially as Best. It stressed that Sally Beauty is a "multi-line" distributor, which means that it distributes many brands and is not just a conduit for Alberto-Culver products. But we do not think that this creates a material question of fact in this case.† When performance of personal services is delegated, the trier merely determines that it is a personal services contract. If so, the duty is *per se* nondelegable. There is no inquiry into whether the delegate is as skilled or worthy of trust and confidence as the original obligor: the delegate was not bargained for and the obligee need not consent to the substitution.‡ And so here: it is undisputed that Sally Beauty is wholly owned by Alberto-Culver, which means that Sally Beauty's "impartial" sales policy is at least acquiesced in by Alberto-

* The effort by the dissent to distinguish *Berliner* merely because the court there apparently assumed in passing that distributorship agreements were a species of personal service contracts must fail. The *Berliner* court emphasizes that the sale of a distributorship to a competitor of the supplier is by itself a wholly sufficient reason to terminate the distributorship.

† We do not address here the situation in which the assignee is not completely under the control of a competitor. If the assignee were only a partially-owned subsidiary, there presumably would have to be fact-finding about the degree of control the competitor-parent had over the subsidiary's business decisions.

‡ Of course, the obligee makes such an assessment of the prospective delegate. If it thinks the delegated performance will be as satisfactory, it is of course free to consent to the delegation. Thus, the dissent is mistaken in its suggestion that we find it improper—a "conflict of interest"—for one competitor to distribute another competitor's products. Rather, we believe only that it is commercially reasonable that the supplier in those circumstances have consented to such a state of affairs. To borrow the dissent's example, Isuzu allows General Motors to distribute its cars because it considers this arrangement attractive. Nor is distrust of one's competitors a trait unique to lawyers (as opposed to ordinary businessmen), as the dissent may be understood to suggest.

Culver — but could change whenever Alberto-Culver's needs changed. Sally Beauty may be totally sincere in its belief that it can operate "impartially" as a distributor, but who can guarantee the outcome when there is a clear choice between the demands of the parent-manufacturer, Alberto-Culver, and the competing needs of Nexxus? The risk of an unfavorable outcome is not one which the law can force Nexxus to take. Nexxus has a substantial interest in not seeing this contract performed by Sally Beauty, which is sufficient to bar the delegation under section 2-210, Tex. Bus. Com. Code Ann. § 2-210 (Vernon 1968). Because Nexxus should not be forced to accept performance of the distributorship agreement by Sally, we hold that the contract was not assignable without Nexxus' consent.*

The judgment of the district court is AFFIRMED.

POSNER, Circuit Judge, dissenting.

[¶1] My brethren have decided, with no better foundation than judicial intuition about what businessmen consider reasonable, that the Uniform Commercial Code gives a supplier an absolute right to cancel an exclusive-dealing contract if the dealer is acquired, directly or indirectly, by a competitor of the supplier. I interpret the Code differently.

[¶2] Nexxus makes products for the hair and sells them through distributors to hair salons and barbershops. It gave a contract to Best, cancellable on any anniversary of the contract with 120 days' notice, to be its exclusive distributor in Texas. Two years later Best was acquired by and merged into Sally Beauty, a distributor of beauty supplies and wholly owned subsidiary of Alberto-Culver. Alberto-Culver makes "hair care" products, too, though they mostly are cheaper than Nexxus's, and are sold to the public primarily through grocery stores and drugstores. My brethren conclude that because there is at least a loose competitive relationship between Nexxus and Alberto-Culver, Sally Beauty cannot—as a matter of law, cannot, for there has been no trial on the issue—provide its "best efforts" in the distribution of Nexxus products. Since a commitment to provide best efforts is read into every exclusive-dealing contract by section 2-306(2) of the Uniform Commercial Code, the contract has been broken and Nexxus can repudiate it. Alternatively, Nexxus had "a substantial interest in having his original promisor perform or control the acts required by the contract," and therefore the delegation of the promisor's (Best's) duties to Sally Beauty was improper under section 2-210(1).

[¶3] My brethren's conclusion that these provisions of the Uniform Commercial Code entitled Nexxus to cancel the contract does not leap out from the language of the provisions or of the contract; so one would expect, but does not find, a canvass of the relevant case law. My brethren cite only one case in support of their conclusion: a district court case from Maryland, *Berliner Foods Corp. v. Pillsbury Co.*, 633 F. Supp. 557 (D.Md.1986),

* This disposition makes it unnecessary to address Nexxus' argument that Sally Beauty breached the distribution agreement by not giving Nexxus 120 days' notice of the Best-Sally Beauty merger.

which, since it treated the contract at issue there as one for personal services, *id.* at 559 (a characterization my brethren properly reject for the contract between Nexxus and Best), is not helpful. Berliner is the latest in a long line of cases that make the propriety of delegating the performance of a distribution contract depend on whether or not the contract calls for the distributor's personal (unique, irreplaceable, distinctive, and therefore nondelegable) services. See, e.g., *Bancroft v. Scribner*, 72 Fed. 988 (9th Cir.1896); *Detroit Postage Stamp Service Co. v. Schermack*, 179 Mich. 266, 146 N.W. 144 (1914); *W.H. Barber Agency Co. v. Co-Op. Barrel Co.*, 133 Minn. 207, 158 N.W. 38 (1916); *Paige v. Faure*, 229 N.Y. 114, 127 N.E. 898 (1920). By rejecting that characterization here, my brethren have sawn off the only limb on which they might have sat comfortably. * * * *

[¶4] The fact that Best's president has quit cannot be decisive on the issue whether the merger resulted in a delegation of performance. The contract between Nexxus and Best was not a personal-services contract conditioned on a particular individual's remaining with Best. Compare *Jennings v. Foremost Dairies, Inc.*, *supra*, 235 N.Y.S.2d at 574. If Best had not been acquired, but its president had left anyway, as of course he might have done, Nexxus could not have repudiated the contract.

[¶5] No case adopts the *per se* rule that my brethren announce. The cases ask whether, as a matter of fact, a change in business form is likely to impair performance of the contract.
* * * *

[¶6] My brethren find this a simple case—as simple (it seems) as if a lawyer had undertaken to represent the party opposing his client. But notions of conflict of interest are not the same in law and in business, and judges can go astray by assuming that the legal-services industry is the pattern for the entire economy. The lawyerization of America has not reached that point. Sally Beauty, though a wholly owned subsidiary of Alberto-Culver, distributes "hair care" supplies made by many different companies, which so far as appears compete with Alberto-Culver as vigorously as Nexxus does. Steel companies both make fabricated steel and sell raw steel to competing fabricators. General Motors sells cars manufactured by a competitor, Isuzu. What in law would be considered a fatal conflict of interest is in business a commonplace and legitimate practice. The lawyer is a fiduciary of his client; Best was not a fiduciary of Nexxus.

[¶7] Selling your competitor's products, or supplying inputs to your competitor, sometimes creates problems under antitrust or regulatory law—but only when the supplier or distributor has monopoly or market power and uses it to restrict a competitor's access to an essential input or to the market for the competitor's output, as in *Otter Tail Power Co. v. United States*, 410 U.S. 366, 93 S.Ct. 1022, 35 L.Ed.2d 359 (1973), or *FTC v. Brown Shoe Co.*, 384 U.S. 316, 86 S.Ct. 1501, 16 L.Ed.2d 587 (1966), or *United Air Lines, Inc. v. CAB*, 766 F.2d 1107, 1114-15 (7th Cir.1985). See also *Olympia Equipment Leasing Co. v. Western Union Telegraph Co.*, 797 F.2d 370, 376-79 (7th Cir.1986). There is no suggestion that Alberto-Culver has a monopoly of "hair care" products or Sally Beauty a monopoly of distributing such products, or that Alberto-Culver would ever have ordered

Sally Beauty to stop carrying Nexxus products. Far from complaining about being squeezed out of the market by the acquisition, Nexxus is complaining in effect about Sally Beauty's refusal to boycott it!

[¶8] How likely is it that the acquisition of Best could hurt Nexxus? Not very. Suppose Alberto-Culver had ordered Sally Beauty to go slow in pushing Nexxus products, in the hope that sales of Alberto-Culver "hair care" products would rise. Even if they did, since the market is competitive Alberto-Culver would not reap monopoly profits. Moreover, what guarantee has Alberto-Culver that consumers would be diverted from Nexxus to it, rather than to products closer in price and quality to Nexxus products? In any event, any trivial gain in profits to Alberto-Culver would be offset by the loss of goodwill to Sally Beauty; and a cost to Sally Beauty is a cost to Alberto-Culver, its parent. Remember that Sally Beauty carries beauty supplies made by other competitors of Alberto-Culver; Best alone carries "hair care" products manufactured by Revlon, Clairol, Bristol-Myers, and L'Oreal, as well as Alberto-Culver. Will these powerful competitors continue to distribute their products through Sally Beauty if Sally Beauty displays favoritism for Alberto-Culver products? Would not such a display be a commercial disaster for Sally Beauty, and hence for its parent, Alberto-Culver? Is it really credible that Alberto-Culver would sacrifice Sally Beauty in a vain effort to monopolize the "hair care" market, in violation of section 2 of the Sherman Act? Is not the ratio of the profits that Alberto-Culver obtains from Sally Beauty to the profits it obtains from the manufacture of "hair care" products at least a relevant consideration?

[¶9] Another relevant consideration is that the contract between Nexxus and Best was for a short term. Could Alberto-Culver destroy Nexxus by failing to push its products with maximum vigor in Texas for a year? In the unlikely event that it could and did, it would be liable in damages to Nexxus for breach of the implied best-efforts term of the distribution contract. Finally, it is obvious that Sally Beauty does not have a bottleneck position in the distribution of "hair care" products, such that by refusing to promote Nexxus products vigorously it could stifle the distribution of those products in Texas; for Nexxus has found alternative distribution that it prefers — otherwise it wouldn't have repudiated the contract with Best when Best was acquired by Sally Beauty.

[¶10] Not all businessmen are consistent and successful profit maximizers, so the probability that Alberto-Culver would instruct Sally Beauty to cease to push Nexxus products vigorously in Texas cannot be reckoned at zero. On this record, however, it is slight. And there is no principle of law that if something happens that trivially reduces the probability that a dealer will use his best efforts, the supplier can cancel the contract. Suppose there had been no merger, but the only child of Best's president had gone to work for Alberto-Culver as a chemist. Could Nexxus have canceled the contract, fearing that Best (perhaps unconsciously) would favor Alberto-Culver products over Nexxus products? That would be an absurd ground for cancellation, and so is Nexxus's actual ground. At most, so far as the record shows, Nexxus may have had grounds for "insecurity" regarding the performance by Sally Beauty of its obligation to use its best efforts to promote Nexxus

products, but if so its remedy was not to cancel the contract but to demand assurances of due performance. See UCC § 2-609; Official Comment 5 to § 2-306. No such demand was made. An anticipatory repudiation by conduct requires conduct that makes the repudiating party unable to perform. Farnsworth, Contracts 636 (1982). The merger did not do this. At least there is no evidence it did. The judgment should be reversed and the case remanded for a trial on whether the merger so altered the conditions of performance that Nexxus is entitled to declare the contract broken.

Questions:

1. Why does the majority think that Sally Beauty might favor Alberto-Culver's products over Nexxus's?
2. Do the assumptions of classical economics help us determine what Sally Beauty might do? Generally, these assumptions are that people engage in rational maximization of their own utility or profits. What does Posner say?
3. What is the legal effect of holding a duty not delegable?
4. Let's suppose that the duty can be delegated. Is the delegating party released?
5. Why are rights freely assignable but duties not freely delegable?
6. Are restrictions on delegation harsher than on assignment?

Howard M. BERG and Sandra Berg v. LIBERTY FEDERAL SAVINGS AND LOAN
ASS'N
Del. (1981), 428 A.2d 347

HORSEY, Justice.

[¶1] This appeal concerns whether a mortgage lender's otherwise available remedies on borrower's default are compromised by lender's dealings with a third party grantee under a debt arrangement with borrower.

[¶2] In 1970, Howard M. Berg and Sandra Berg (borrowers) executed, for valuable consideration, a bond and mortgage of real estate in favor of Liberty Federal Savings and Loan Association (lender). In 1973, borrowers sold the real estate to a third party (grantee) who assumed liability for the mortgage indebtedness. Lender was not a party to the transaction and did not execute any contract of novation or instrument releasing borrowers from liability under their bond and mortgage. However, lender thereafter accepted timely monthly payments on the mortgage from grantee; and all further correspondence from lender concerning the mortgage was with grantee until payments ceased in late 1977.

[¶3] In early 1978 lender, after notifying borrowers that the mortgage was four months in arrears and hence in default, instituted suit against borrowers on their bond. Borrowers resisted, contending that lender, by its conduct, had "accepted" or "recognized" grantee's assumption of the mortgage and thereby legally relinquished its right otherwise to pursue concurrent remedies: that is to sue either on the bond or mortgage.* Lender then moved for partial summary judgment on borrowers' defense.

[¶4] Accepting for purposes of the motion borrowers' factual pleading of "recognition," Superior Court granted lender partial summary judgment. The Court found no legal support for the proposition that lender, by accepting mortgage payments from grantee, "was required to look to the land and foreclose on the mortgage prior to bringing an action on the bond."

[¶5] Later, Superior Court, after further discovery and hearing, summarily granted lender a money judgment against borrowers or their bond notwithstanding borrowers' affidavit of defense. Borrowers then docketed this appeal from both orders.

I

[¶6] The first issue in this appeal concerns a mortgage lender's available remedies against a mortgagor upon default of a nonconsensual assuming grantee,[†] absent a novation or release of the mortgagor. Appellants-mortgagors contend that lender, by accepting timely mortgage payments from grantee and by otherwise dealing with grantee rather than with mortgagor until default, was required to foreclose the mortgage before proceeding against mortgagors on their underlying bond. Mortgagors contend that Superior Court erred in applying irrelevant novation and release criteria in granting lender-plaintiff partial summary judgment dismissing mortgagors' "recognition" defense as insufficient as a matter of law.

A.

[¶7] As between a mortgage lender and a borrower-mortgagor who, by bond or note is personally bound, the law is clear and undisputed as to the creditor's rights: that on debtor's default, lender may, at its option, either sue on the bond or foreclose on the mortgage. 59 C.J.S. Mortgages § 342, p. 473. No implication arises from the mere taking of collateral security that a creditor will look only or primarily to the security for repayment of the loan. 55 Am.Jur.2d, Mortgages, § 536, p. 517. A creditor-mortgagee may pursue all available remedies concurrently or successively, to the extent that separate and distinct remedies are

* Borrowers also raised an alternative defense of "release" that lender, by its conduct, had released borrowers from liability on their bond. However, borrowers did not pursue this defense either by motion to dismiss or cross-motion for summary judgment.

[†] i. e., a grantee who assumed the mortgage on purchase of the real estate securing the loan from mortgagor without the knowledge and consent of mortgagee.

recognized at law or in the controlling instrument. 59 C.J.S. Mortgages § 485, p. 767 and 3 Jones on Mortgages (8th Ed.), § 1565. Such has been the law of Delaware for over a century and a half. *Newbold v. Newbold*, Del.Ch., 1 Ch. 310 (1825), stating that it was "clearly and reasonably settled that a mortgagee may use all the remedies upon a bond and mortgage which the law affords, at the same time, and consequently any one of them which he prefers." 1 Ch. at 315.

[¶8] Absent a release or contract of novation, a mortgagor is not exonerated from personal liability on his bond or note by conveying the mortgaged premises to a third party who assumes the mortgage regardless of lender's acceptance of grantee's payments on the mortgage, assuming the terms of repayment are not varied. 2 Jones on Mortgages (8th Ed.), § 920; 55 Am. Jur.2d, Mortgages, § 1045, p. 886, 59 C.J.S. Mortgages § 415, p 592; 41 A.L.R., 317 Ann.: Assumption of Mortgage by Grantee as Affecting Right of Mortgagee to Proceed Against the Mortgagor.

[¶9] A novation will not be presumed but must be proved, with the burden of proof thereof resting on the proponent. 58 Am.Jur.2d, Novation, § 20, p. 535 and § 32, p. 542. It has been held that a creditor's knowledge of a debt assumption and acceptance of payments on the debt from assumptor is not sufficient to effect a novation or release of the original debtor. Creditor's expressed assent to give up the original debt is required. *North Western Mut. Life Ins. Co. v. Eddleman*, Ky., 247 Ky. 116, 56 S.W.2d 561 (1933); *Davenport v. Dickson*, Kan.Supr., 211 Kan. 306, 507 P.2d 301 (1973) and *Miami Nat. Bank v. Forecast Const. Corp.*, Fla.App., 366 So.2d 1202 (1979).

B.

[¶10] Appellants do not dispute the foregoing rule of law but contend that it does not control the instant case because appellants are not seeking exoneration based on release or novation but merely a reordering of lender's remedial rights. Appellants contend that Delaware case law supports their position regardless of foreign authority. * * * *

[¶11] Here there is no allegation or evidence that lender varied the terms of the debt instruments after grantee assumed the mortgage and became the primary obligor. Hence, Superior Court's finding of lender's acceptance or "recognition" of grantee's assumption of the mortgage does not remove the case from the controlling rules set out under I A * * * above.

[¶12] Lender's acceptance of timely mortgage payments from grantee over a period of four years and related correspondence was insufficient as a matter of law to alter lender's right under the terms of mortgagor's bond and firmly established precedent to proceed, on default, at its option either on the bond or to foreclose on the mortgage. The terms of appellants' bond expressly conferred this right upon lender. * * * *

AFFIRMED.

Questions:

1. An accord is an agreement by an obligee to accept a substitute performance in place of the obligor's original obligation. Satisfaction is the performance of the substitute performance. What is the difference between a novation and an accord and satisfaction?
2. Smith Homes, Inc., a homebuilder, contracts to build me a house. Immediately after executing the contract, Smith Homes calls subcontractors. For instance, Smith Homes hired Moore Plumbing to install all the plumbing. Has Smith breached? If Moore installs the plumbing badly, has Smith breached? Also, can I sue Moore? That last question is addressed in the next section.

C. Third-Party Beneficiaries

James C. BAIN v. John GILLESPIE
Iowa App. (1984), 357 N.W.2d 47

SNELL, Presiding Judge.

[¶1] James C. Bain serves as a referee for college basketball games. During a game which took place on March 6, 1982, Bain called a foul on a University of Iowa player which permitted free throws to a Purdue University player. That player scored the point that gave Purdue a last-minute victory. Some fans of the University of Iowa team blamed Bain for their team's loss, asserting that the foul call was clearly in error.

[¶2] John and Karen Gillispie operate a novelty store in Iowa City, specializing in University of Iowa sports memorabilia. The store is known as Hawkeye John's Trading Post. Gillispie's business is a private enterprise for profit having no association with the University of Iowa or its sports program.

[¶3] A few days after the controversial game, Gillispies began marketing T-shirts bearing a reference to Bain. It showed a man with a rope around his neck and was captioned "Jim Bain Fan Club." On learning of it, Bain sued Gillispies for injunctive relief, actual and punitive damages. Gillispies counterclaimed, alleging that Bain's conduct in officiating the game was below the standard of competence required of a professional referee. As such, it constituted malpractice which entitles Gillispies to \$175,000 plus exemplary damages. They claim these sums because Iowa's loss of the game to Purdue eliminated Iowa from the championship of the Big Ten Basketball Conference. This in turn destroyed a potential market for Gillispies' memorabilia touting Iowa as a Big Ten champion. Their claim for actual damages is for loss of earnings and business advantage, emotional distress and anxiety, loss of good will, and expectancy of profits. Exemplary damages are asked

because Bain's calls as a referee were baneful, outrageous, and done with a heedless disregard for the rights of the Gillispies.

[¶4] The trial court found the Gillispies had no rights and sustained a motion for summary judgment dismissing Gillispies' counterclaim. They appeal, contending the trial court erred in finding no genuine issue of material fact. The triable issues claimed are: * * * that Gillispies are beneficiaries of an employment contract between Bain and the Big Ten Athletic Conference. * * * *

[¶5] In addition to the parties' briefs, the National Association of Sports Officials (NASO) has filed a motion to appear as *amicus curiae* and to file a brief on behalf of appellee Bain. NASO is an association of sports officials who officiate sports at all levels of competition. It has approximately 9000 members residing in all 50 states. We have granted the motion and considered the brief. * * * *

[¶6] The trial court also found that there was no issue of material fact on the Gillispies' claim that they were beneficiaries under Bain's contract with the Big 10. Gillispies argue that until the contract is produced, there exists a question of whether they are beneficiaries. There is some question of whether there is a contract between Bain and the Big 10. In his response to interrogatories, Bain stated that he had no written contract with the Big 10, but that there was a letter which defined "working relationship." Although this letter was never produced and ordinarily we would not decide an issue without the benefit of examining the letter's contents, we nevertheless find the issue presently capable of determination. By deposition Gillispies answered that there was no contract between them and Bain, the Big 10 Athletic Conference, the University of Iowa, the players, coaches, or with any body regarding this issue. Thus, even if the letter were considered a contract, Gillispies would be considered third-party beneficiaries. Because Gillispies would not be privy to the contract, they must be direct beneficiaries to maintain a cause of action, and not merely incidental beneficiaries. *Khabbaz v. Swartz*, 319 N.W.2d 279, 284 (Iowa 1982).

[¶7] A direct beneficiary is either a donee beneficiary or a creditor beneficiary. *Id.* In *Olney v. Hutt*, 251 Iowa 1379, 105 N.W.2d 515 (1960), the Iowa Supreme Court defined these terms as follows:

(1) Where performance of a promise in a contract will benefit a person other than the promisee that person is, * * * (a) a donee beneficiary if it appears from the terms of the promise in view of the accompanying circumstances that the purpose of the promisee in obtaining the promise of all or part of the performance thereof is to make a gift to the beneficiary or to confer upon him a right against the promisor to some performance neither due nor supposed or asserted to be due from the promisee to the beneficiary; (b) a creditor beneficiary if no purpose to make a gift appears from the terms of the promise in view of the accompanying circumstances and performance of the promise will satisfy an actual or supposed or asserted duty of the promisee to the beneficiary.

Id. at 1386, 105 N.W.2d at 519.

[¶8] Gillispies make no claim that they are creditor beneficiaries of Bain, the Big 10 Athletic Conference, or the University of Iowa. "The real test is said to be whether the contracting parties intended that a third person should receive a benefit which might be enforced in the courts." *Bailey v. Iowa Beef Processors, Inc.*, 213 N.W.2d 642, 645 (Iowa 1973), cert. denied 419 U.S. 830, 95 S.Ct. 52, 42 L.Ed.2d 55 (1974). It is clear that the purpose of any promise which Bain might have made was not to confer a gift on Gillispies. Likewise, the Big 10 did not owe any duty to the Gillispies such that they would have been creditor beneficiaries. If a contract did exist between Bain and the Big 10, Gillispies can be considered nothing more than incidental beneficiaries and as such are unable to maintain a cause of action. *Olney v. Hutt*, 251 Iowa 1379, 1386, 105 N.W.2d 515, 518 (1960).

[¶9] Consequently, there was no genuine issue for trial which could result in Gillispies obtaining a judgment under a contract theory of recovery. The ruling of the trial court sustaining the summary judgment motion and dismissing the counterclaim is affirmed.

AFFIRMED.

Questions:

1. Iowa followed the Restatement of Contracts categories. Can you think of an example of a creditor beneficiary? Why would the court want to grant rights to a creditor beneficiary?
2. What is a donee beneficiary? Why would the court want to grant rights to a donee beneficiary?
3. Does the *Bain* case have anything to do with the intent of the Big 10?

SIMON v. ZIPPERSTEIN
Ohio (1987), 32 Ohio St. 3d 74

Per Curiam.

[¶1] The sole consideration presented by this appeal is whether in the absence of fraud, collusion or malice, an attorney may be held liable in a malpractice action by a beneficiary or purported beneficiary of a will where privity is lacking. For the reasons that follow, we answer this question in the negative and reverse the judgment of the court of appeals.

[¶2] It is by now well-established in Ohio that an attorney may not be held liable by third parties as a result of having performed services on behalf of a client, in good faith, unless the third party is in privity with the client for whom the legal services were performed, or unless the attorney acts with malice. [Long list of citations omitted.]

[¶3] The rationale for this posture is clear: the obligation of an attorney is to direct his attention to the needs of the client, not to the needs of a third party not in privity with the client. As was stated by the court in *W.D.G., Inc.*, *supra*:

"* * * Some immunity from being sued by third persons must be afforded an attorney so that he may properly represent his client. To allow indiscriminate third-party actions against attorneys of necessity would create a conflict of interest at all times, so that the attorney might well be reluctant to offer proper representation to his client in fear of some third-party action against the attorney himself." *Id.* at 399-400.

We emphasize that our view on the liability of attorneys to third-persons as a result of services performed in good faith on behalf of a client is shared by other jurisdictions. See [long list of citations, omitted].

[¶4] In the instant case, appellee's complaint set forth no special circumstances such as fraud, bad faith, collusion or other malicious conduct which would justify departure from the general rule. In addition, privity was lacking since appellee, as a potential beneficiary of his father's estate, had no vested interest in the estate. *Cf. Cunningham v. Edward* (1936), 52 Ohio App. 61, 6 O.O. 98, 3 N.E.2d 58. Although the court of appeals acknowledged the applicability of *Scholler*, *supra*, it elected to disregard the holding based upon "public policy" grounds. We disapprove of the approach taken by the court of appeals and its refusal to adhere to precedent. We reiterate our holding in the first paragraph of the syllabus of *Scholler* that "[a]n attorney is immune from liability to third persons arising from his performance as an attorney in good faith on behalf of, and with the knowledge of his client, unless such third person is in privity with the client or the attorney acts maliciously."

[¶5] For the foregoing reasons, the judgment of the court of appeals is hereby reversed, and the judgment of the trial court is reinstated.

Judgment reversed.

[¶1] BROWN, J., dissenting. I must respectfully dissent. The result reached by the majority means that an attorney who negligently prepares a will is immune from liability for malpractice. For example, if an attorney carelessly fails to see that the will is signed by the required number of witnesses, no action can be brought against the inattentive lawyer. This is so because the client, the testator, must die before the will becomes operative. Nonetheless, only the client, says the majority, may bring the malpractice action. To reach this undesirable result, the majority trots out that old chestnut, privity.

[¶2] In the law of torts, the use of privity as a tool to bar recovery has been riddled (and rightly so) to the extent that we are left with legal malpractice as, perhaps, the only surviving relic. For example, a physician who negligently injures a spouse or a minor child is responsible to the other spouse or to the parent(s) for their corresponding loss of consortium or loss of services, notwithstanding the absence of privity. [Long list of citations omitted.] Likewise, an architect or builder who defectively designs or constructs

a building is liable to a person thereby injured, despite a lack of privity. *Kocisko v. Charles Shutrump & Sons Co.* (1986), 21 Ohio St.3d 98, 101, 21 OBR 392, 394, 488 N.E.2d 171, 174 (Wright, J., dissenting). Additionally, the manufacturer of a defective product is not excused for want of privity from liability to an injured user. *Temple v. Wean United, Inc.* (1977), 50 Ohio St.2d 317, 4 O.O. 3d 466, 364 N.E.2d 267. Even an accountant is no longer immune from liability to third persons who foreseeably rely upon his or her negligent representations. *Haddon View Investment Co. v. Coopers & Lybrand* (1982), 70 Ohio St.2d 154, 24 O.O. 3d 268, 436 N.E.2d 212.

[¶3] While the court of appeals below should perhaps have given greater obeisance to *Scholler v. Scholler* (1984), 10 Ohio St.3d 98, 10 OBR 426, 462 N.E.2d 158, this court is under no such duty. The requirement of privity in a legal malpractice action should be put to a well-deserved burial. Such is not to abandon *stare decisis*, but rather to bring attorney malpractice—based upon professional negligence—into line within the body of tort law.

[¶4] What the majority has done is to make a mechanical application of *Scholler*, *supra*, to the facts of the cause *sub judice*. Then, the majority blandly claims that its view is "shared by other jurisdictions." The issue before us is not that simple. An examination of the seven cases cited by the majority reveals that only two involve an attorney's negligence in drafting a will. See *St. Mary's Church of Schuyler v. Tomek* (1982), 212 Neb. 728, 325 N.W.2d 164, and *Maneri v. Amodeo* (1963), 38 Misc.2d 190, 238 N.Y. Supp. 2d 302. The remaining five cases arise from a potpourri of factual situations, having nothing to do with the issue before us.

[¶5] Actually, most courts that have faced the issue have been unwilling to use privity to insulate attorneys from liability for negligent will preparation. See [long list of citations]. These courts have perceptively emphasized that in drafting a will, the attorney knows that (1) the client has employed him or her for the specific purpose of benefiting third persons, and (2) the consequences of an error by the lawyer will most likely fall upon those intended beneficiaries rather than upon the client.

[¶6] The majority has unfortunately been blinded by the mirage of conflict of interest. The majority states, and I agree, that "the obligation of an attorney is to direct his [or her] attention to the needs of the client, not to the needs of a third party not in privity with the client." Where the attorney's job is to draft a will, however, the needs of the client simply require the attorney to competently construct an instrument that will carry out the client's intentions as to the distribution of his or her property upon death. If the attorney negligently fails to fulfill those needs, with the result that an intended beneficiary receives less than the client desired, surely the client, if he or she were still alive, would want the intended beneficiary to bring an action against the attorney. The conflict-of-interest bugaboo is nonexistent in such a case.*

* The California Supreme Court has explained: "When an attorney undertakes to fulfill the testamentary instructions of his client, he realistically and in fact assumes a relationship not only with the client but also

[¶7] I would hold that an attorney who negligently drafts a will is not immune from liability to those persons whom the testator intends to be beneficiaries thereunder.

Question: The Oregon Supreme Court, in *Hale v. Groce*, 744 P.2d 1289 (Or. 1987), said in a similar case, “We agree that the beneficiary in these cases is not only a plausible but a classic ‘intended’ third-party beneficiary of the lawyer’s promise to his client within the rule of Restatement section 302(1)(2) and may enforce the duty so created” Really? Is the court correct? The testator is dead. What is the testator’s most likely intent?

PROBLEMS

For these problems, see if you can determine what the answer should be. Your professor will confirm or deny your analysis in class.

PROBLEM 18: A mortgages Blackacre to Bank to secure a thirty-year promissory note. After five years of making payments, A sells Blackacre to C, and C assumes the loan, meaning that C promises A that C will pay all of the remaining payments to Bank and, in general, perform as A would have under the promissory note and mortgage. Is Bank a third-party beneficiary of the contract between A and C?

PROBLEM 19: A mortgages Blackacre to Bank to secure a thirty-year promissory note. After five years of making payments, A sells Blackacre to C subject to the mortgage. C promises to pay A the exact payments that A will owe to Bank under A’s promissory note and mortgage. Is Bank a third-party beneficiary of the contract between A and C?

PROBLEM 20: Owner hires Contractor to remodel owner’s home. Contractor hires Subcontractor to change the plumbing in the kitchen. Later, the plumbing in the kitchen installed by Subcontractor breaks, and Owner’s house is flooded. May Owner sue Subcontractor for the damages?

PROBLEM 21: Owner, a state agency, hired Contractor to build a school. Owner required Contractor as part of the deal to obtain a surety bond in favor of the Owner called a “Payment Bond.” The bond was in the total amount of the contract, and in it the surety company promised to pay subcontractors, workers, and suppliers if the Contractor failed to pay. On payment of all subcontractors, workers, and suppliers, the bond by its terms becomes void. Contractor proceeded with the building, but as the building was

with the client’s intended beneficiaries. The attorney’s actions and omissions will affect the success of the client’s testamentary scheme; and thus the possibility of thwarting the testator’s wishes immediately becomes foreseeable. Equally foreseeable is the possibility of injury to an intended beneficiary. In some ways, the beneficiary’s interests loom greater than those of the client. After the latter’s death, a failure in his testamentary scheme works no practical effect except to deprive his intended beneficiaries of the intended bequests.” *Heyer v. Flaig* (1969), 70 Cal.2d 223, 228, 74 Cal.Rptr. 225, 228-229, 449 P.2d 161, 164-165.

substantially finished, the Contractor became insolvent and filed for bankruptcy. Owner had already paid Contractor 90% of the contract price. Several subcontractors were not paid, however. They would file mechanics' liens on the property if it were not property of the state, but because it is, they cannot. Subcontractors are owed funds equaling 30% of the entire cost of the building. Owner refused to pay. Should the subcontractors file an action against the surety company?

PROBLEM 22: Twelve families, each headed by a US veteran, bought homes from Schmidt. The homes were built pursuant to a contract Schmidt had with the Federal Home Administration, or FHA, which engaged in such contracts pursuant to a regulation that gave priority in building materials to construction of homes for veterans. When Schmidt applied for his priority, he was required to submit plans that complied with FHA regulations. The homes had to include exterior wood walls, two 30,000 BTU gas floor furnaces, and interior walls of plaster. The homes also had to sell for \$120,000 or less. When the homes were built, instead of wood exterior walls, they had paper covered with stucco. They each had only one gas furnace. Interior walls were built with sheet rock. The homes leaked, were cold, and developed mold and mildew because of Schmidt's failures to perform according to his agreement with the FHA. However, when the twelve families bought the homes, each was aware of how they were made and that they each contained only the one heater. None of the families was aware of the content of Schmidt's contract with the FHA. The twelve families later sued Schmidt as third-party beneficiaries of Schmidt's contract with the FHA. What result? This problem is based on *Shell et al. v. Schmidt*, 272 P.2d 82 (Cal. App. 1954).

Courts normally hold that a third-party beneficiary's rights are subject to any claims or defenses that the promisor has against the promisee.

PROBLEM 23: Jim owned a 1972 Nova, red, with a big spoiler on the back. Jim was insured by All-State Insurance Co. with auto insurance required by law. The auto policy contained an arbitration clause requiring arbitration of any claims arising out of or in connection with the obligation to provide insurance in the contract. Jim negligently caused an accident in which Shelley's 1972 Nova, blue, with custom leather seats, was wrecked and Shelley was injured. Jim is poor, and his car was his sole asset of any value. Shelley therefore has sued All-State, claiming to be a third-party beneficiary of Jim's policy. Assuming she is, will she have to arbitrate her claim?