

# Contract Doctrine, Theory & Practice

*Second Edition*



**J H VERKERKE**

PROFESSOR OF LAW  
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# CONTRACT DOCTRINE, THEORY & PRACTICE

Second Edition

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## **ABOUT THE AUTHOR**

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A pioneer in the use of technology to support legal education, Verkerke was selected as an inaugural member of the University Academy of Teaching and won an All-University Teaching Award in 2007. In 2012, he received a Hybrid Challenge Grant for Technology-Enhanced Teaching to transform his first-year contracts class using the flipped classroom model of instruction. He previously chaired the University Committee on Information Technology.

Verkerke's published research focuses on employment discrimination law, employment contracts, vicarious liability, the economics of discrimination, and contract theory. He has co-authored an empirical study of law school teaching practices and how those methods affect student experiences and outcomes.

## NOTICES

This Second Edition is an adaptation of the original 3-volume casebook by the same name, published October 2024. Visit [the eLangdell bookstore](#) for the latest version and for the original 3-volume edition.

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## ABOUT ELANGDELL PRESS

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## PREFACE

This book includes all of the elements that make up a conventional casebook. You will read judicial opinions, statutory provisions, academic essays, and hypotheticals. You will puzzle over common law doctrines and carefully parse statutes. We will try to develop theories that can predict and justify the patterns of judicial decisions we observe.

Unlike a conventional casebook, however, you will not spend the semester hauling around hundreds of extra pages that we have no time to read or discuss. At the end of each section, you will find discussion questions that will help prepare you to answer questions during class discussion. In addition, the pages themselves are formatted to make reading easier and to give you plenty of space to take notes and mark up the text.

Available separately is a collection of principal cases discussed in these materials. This format enables you to disassemble the volume of principal cases and bring only those cases you need for each day's class discussion. Download the principal cases file at [www.cali.org/books/contract-doctrine-theory-practice-2d](http://www.cali.org/books/contract-doctrine-theory-practice-2d).

Throughout this book you will find links to screencast videos directly related to topics covered in the readings. I encourage you to view these videos alongside the readings to reinforce your understanding of each topic. Access the entire playlist on YouTube at [https://www.youtube.com/playlist?list=PLbHXrwmlOuqlR5DZCaZxdRPDa\\_nSSKXsH](https://www.youtube.com/playlist?list=PLbHXrwmlOuqlR5DZCaZxdRPDa_nSSKXsH).

Finally, you will also find instructions to read sections of the Restatement (Second) of Contracts. Consult your instructor or law librarian for access to Restatement and UCC provisions.

*Why study contract law?*

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

intellectual property law, and dozens of other practice areas, your knowledge of contract doctrine and theory will be invaluable.

*Who has helped create these teaching materials?*

I gratefully acknowledge the extraordinary work of my talented research assistants who have been instrumental in helping me to put these materials together. Thanks to Sarah Bryan, Mario Lorello, Elizabeth Young, Vishal Phalgoo, Valerie Barker, Clark Warthen, Colin Thompson, and Holly Chaisson.

I believe that it is important to involve students in the ongoing process of refining and improving how we teach legal subjects. Please contact me if there is anything about these materials that could be improved. I hope studying with this book will guide you on a challenging, but ultimately rewarding, intellectual journey.



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# INTRODUCTORY CLASSROOM ACTIVITIES

## 1. Negotiate Course Technology Policies

This exercise gives students an opportunity to form small groups for discussion and get to know their classmates. In addition, negotiating a "contract" to determine the Classroom Technology Use Policy for the semester will illuminate several themes that recur throughout the course. In preparation for this exercise, please read the course syllabus and review the menu of suggested policy options below.

---

### *Options for our Classroom Technology Use Policy*

- a) **Anything Goes** – Individual students judge for themselves what classroom uses of electronic devices are appropriate. Other students are free to express their views about distracting uses, but non-academic uses are not a violation of our course policy.
- b) **Academic Use Only** – The only permissible classroom use of electronic devices is to support academic activities related to our coursework.
- c) **Academic Use with Exception for Important Communications** – We ordinarily follow the principle of academic use only, but on those rare occasions when a student is expecting an important communication during class time, this policy permits that non-academic use.
- d) **Designated Zones for Different Preferences** – We establish physical spaces in the classroom designated for students with differing preferences about using electronic devices. One side or row of the classroom is reserved for students wishing to have the freedom to check email and browse the web. Other students may choose a classroom zone free of these distractions.
- e) **Individual Precommitment** – Each student chooses an individually tailored policy for technology use. Responding to poll questions may require a web-

enabled device in class, but a student might wish to commit to put away that device at all other times. Breaching this precommitment would be a violation of our course policy.

f) **Something Else** – Students may propose additional policy options.

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Consider what position you wish to take in our negotiations about this policy. Before the start of class, please write down your position. You may refer to an option from the menu above, devise an amended version of one of those options, or suggest another alternative entirely.

During class, we will begin by polling students to determine your initial preferences about this issue. Then each small group will discuss the policy options. Your goal will be to reach a consensus in your group. After a few minutes for small group discussion, we will reconvene as a whole class and attempt to negotiate an agreement on the terms of the technology policy. If the class is able to agree, then these terms will become a binding course policy. If we are unable to reach an agreement, then your professor will select an option from the menu of alternatives or those proposed during our negotiations.

Aside from giving students a chance to shape part of the course, the goal of this negotiation exercise is to create a personal experience that will make more concrete some of the fundamental concepts that underlie the law of contracts. You will be confronted with many of the challenges that face contracting parties in the "real world" along with a few unique complications that arise from our distinctive circumstances.

Here are a few questions you might wish to ask yourself as the negotiation exercise unfolds:

- What are your objectives in this negotiation?
- How will the other parties to the negotiation and the broader environment in which you are negotiating affect your ability to achieve your objectives?

- What happens if the negotiations fail?
- Is there anything you can do to improve the prospects for agreement?

You may also wish to think about how our own negotiation can shed light on the broad themes of this course. It is helpful to think of contract law as attempting to answer the following broad questions:

- Do the parties intend to make an enforceable promise?
- What must they do to form a contract?
- How do we know whether they have performed (or not)?
- In the event of a breach, what remedy is available?
- What legal regulations might affect parties' ability to make and enforce contracts?

Consider how each of these themes might apply to our own negotiation over course policies. Ask yourself whether our experience can shed light on more conventional commercial negotiations.

## **2. Introduction to Reading Cases**

The purpose of this second exercise is to give you some early guidance about the crucial lawyerly skill of reading a judicial opinion. After you have completed these readings and exercises, you will be familiar with the information commonly found in opinions, and you will have studied closely how the various components of a judicial opinion come together for one case. First, read the court's opinion in *Bailey v. West* on your own.

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Please read *Bailey v. West* in your volume of Principal Cases.

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View the screencast video on [A Brief Introduction to Reading Cases](#).

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Next, please read *Bailey v. West* again. Focus during this rereading of *Bailey* on distinguishing the various elements of the court's opinion. Try to identify the passages that present facts—the story of the case. Distinguish also portions of the opinion that:

- describe the procedural history of the case,
- cite relevant legal authority,
- analyze how those legal rules apply to the facts of this case, and
- announce the court's decision.

Now, write a detailed chronological account of what happened in *Bailey v. West*. Begin with the relevant facts. Tell the story of what occurred between Bailey and West that led Bailey to file a lawsuit. Next describe the story of the litigation. How did the case begin? What happened along the way? How was the case ultimately resolved? For the purpose of this initial writing assignment on *Bailey*, please omit the appellate court's reasoning and any relevant legal authority from your chronology. Focus instead on preparing a comprehensive account of what happened from the beginning of the story through the moment that the court announced its decision.

I also encourage you to give some thought to why such a chronology might be useful to a practicing attorney. Consider how best you can develop the skill of organizing events in this way. Be sure to apply these new skills as you read other cases. It is emphatically not necessary to write out a detailed chronology or even to prepare an exhaustive brief for every case you cover in every course. Instead, you should develop a method of reading cases and taking notes on them that allows you to recall the most important features of the case. You should aim to remember enough about the structure of the opinion(s) so that you can readily find more obscure information when you need it.



# **I. INTRODUCTION TO THE LEGAL SIGNIFICANCE OF PROMISE MAKING**

The goal of this chapter is to introduce you to some of the fundamental questions that organize our study of contract law and theory. At least initially, we will focus exclusively on the judge-made rules of the “common law.” Prior judicial decisions—often referred to as “precedents”—comprise the only legally authoritative source of the common law. However, the American Law Institute (ALI), a prestigious organization of judges, professors, and practicing lawyers, has promulgated “Restatements” for many core areas of the law, including contracts. We will study various sources of contract law in more detail soon, but for the moment, bear in mind that the Restatement (Second) of Contracts mentioned repeatedly in these reading materials is an influential formulation of the law of contracts.

## **1. What is a Promise?**

We begin by considering what it means to make a promise. Let’s forget for just a moment about the law and think instead what normal people mean when they talk about a promise. Suppose that your professor tells you on the first day of class: “I promise that you’ll enjoy Contracts this semester.” Consider how we should understand this “promise.”

Does the fact that the statement is oral rather than in writing make any difference? Is there anything about the circumstances in which this statement is made that undermines your confidence that the professor intends for this “promise” to be binding?

Read the first four sections of the Restatement and consider how the legal use of the term “promise” relates to our common sense understanding of the word.

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Please read sections 1-4 of the RESTATEMENT (SECOND) OF CONTRACTS.

---

*Questions for discussion:*

Try to identify the essential elements or components of the legal meaning of the word “promise.” Can you draw a diagram to represent how these elements relate to one another?

Consider also why people make promises. Why not just perform the act? Why talk about it first?

**1.1 *Bailey v. West***

Our first principal case continues to explore what it means to make a promise. As you reread the court’s opinion, think carefully about how each party to the litigation would describe the facts or tell the story of what happened. Consider also the “procedural history” and the “procedural posture” of the case when it reaches the Rhode Island Supreme Court. How has the litigation progressed? Who sued whom? What has happened so far? Who won at each stage, and what did they get in the way of remedies? How does the Rhode Island Supreme Court resolve the case?

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Please reread *Bailey v. West* in your volume of Principal Cases.

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*Questions for discussion of the implied contract claim in Bailey v. West:*

Try now to identify the key legal questions that the court thought it should resolve. How does the court rule on these questions? Where does the court find legal authority to support its resolution of the case? What facts did the court think were most relevant to its decision? Can you think of how we might argue that Bailey rather than West should have prevailed?

One way of thinking about this case is to ask whether the court should endorse Bailey’s or West’s expectations about the alleged boarding contract. Is there any common thread that can unify our efforts to analyze the parties’ expectations? What word could we use to describe the test that the court applies to decide whether Bailey has a legal right to expect payment for boarding Bascom’s Folly?

Are you happy living under a rule that refuses to protect Bailey's expectations? What would happen if we were to flip the rule and force West to pay Bailey for boarding his horse? Would it be good to require people like West to anticipate how people like Bailey will interpret situations like this one?

## **1.2 *Lucy v. Zehmer***

Our second principal case addresses another context in which the parties dispute the existence of a promise. As you read the opinion, ask yourself from whose perspective the court chooses to evaluate Zehmer's alleged promise to sell his farm.

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Please read *Lucy v. Zehmer* in your volume of Principal Cases.

---

### *Questions for discussion:*

How does the court respond to Zehmer's contention that his offer to sell the Ferguson farm was in jest?

Can you construct an argument to justify the court's approach?

How would future parties respond if the legal rule favored Zehmer rather than Lucy in these circumstances?

### **1.2.1 Note on *Leonard v. Pepsico***

Sometimes a purported promise is merely a joke. In the celebrated case of *Leonard v. Pepsico*, 88 F. Supp. 2d 116 (S.D.N.Y. 1999), the court considered Leonard's claim that a "Pepsi Stuff" commercial constituted a promise to redeem 7,000,000 Pepsi Points for a Harrier Jet. Leonard submitted an order form, fifteen Pepsi Points, and a check for \$700,008.50 to purchase the remaining points. Although the order form offered additional points at 10 cents each, it did not list the jet as an available premium. Leonard wrote "1 Harrier Jet" in the "Item" column and "7,000,000" in the "Total Points" column. Pepsico returned Leonard's submission and explained that the company had included the images of the Harrier Jet for comic effect. The court similarly rejected plaintiff's claim and opined that:

[N]o objective person could reasonably have concluded that the commercial actually offered consumers a Harrier Jet.... In evaluating the commercial, the Court must not consider defendant's subjective intent in making the commercial, or plaintiff's subjective view of what the commercial offered, but what an objective, reasonable person would have understood the commercial to convey... If it is clear that an offer was not serious, then no offer has been made: An obvious joke, of course, would not give rise to a contract.

*Id.* at 137.

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View the screencast video on [Objective Intent](#).

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### **Preparing for Class Discussion – Objective Intent**

Focus first on how the common understanding of what it means to make a promise relates to the legal meaning of the word "promise." Also consider why people promise rather than simply perform an act.

Next, explore the *Bailey* court's reasoning in response to Bailey's implied-in-fact contract claim. It is important to identify the legal rules on which the court based its decision—the "relevant law." Then you can identify the facts that the court thought were most relevant to resolving this dispute. Notice that these facts were the centerpiece of West's argument. This is how West told the story of the case to convince the court that he had not made an enforceable promise.

We know that Bailey lost in the Rhode Island Supreme Court and recovered nothing for boarding Bascom's Folly. Imagine that your law firm has been retained to help prepare a motion for reconsideration and that you have to convince the court that Bailey actually had a contract with West. In particular, you should concentrate on telling the story from Bailey's perspective. How could Bailey argue that the specific facts the court found relevant do not support a judgment for West and thus build an argument for contractual liability?

Taking for the first time a more theoretical approach, consider what principle unifies our efforts to explain Bailey's conduct. This exercise in descriptive and predictive legal theory lead us naturally to consider whether the principle we identify is normatively desirable. Would the world be better (or worse) off if we were to adopt the opposite rule (enforcing Bailey's expectations)? We can analyze this question in terms of economic efficiency or as one of political morality. Throughout these materials, we will repeatedly resort to this technique of "flipping the rule" to explore the underlying justifications for various legal doctrines.

Turning to *Lucy v. Zehmer*, apply your growing understanding of what sort of intent is required to make a legally enforceable promise. The formal legal basis for the court's ruling should be readily apparent. There can be no doubt that the *Lucy* court applies the now universally accepted doctrinal rule that we evaluate contractual intent according to an objective standard. Thus, the court concludes that it was objectively reasonable for Lucy to believe that the Zehmers intended to sell him the Ferguson Farm for \$50,000.

After making sure that you understand the prevailing "black letter" legal rule, focus first on a few passages in the court's opinion that explore facts that are not strictly speaking relevant under that rule. Identify evidence the *Lucy* court discusses that arguably relates only to Zehmer's *subjective* intent to contract. Try to understand why the court considers this evidence despite the fact that it has no obvious relevance to determining whether Lucy reasonably understood that the Zehmers had agreed to sell the farm. Then, again, "flip the rule" and consider what would happen if parties like Zehmer were able to avoid contractual liability.

We can conclude our discussion of objective intent with an analysis of the note case *Leonard v. Pepsico*. You have read about Leonard's unsuccessful attempt to enforce Pepsico's "Pepsi Stuff" advertisement as a promise to exchange 7,000,000 Pepsi Points for a Harrier jet. The court had very little trouble concluding that Leonard was not justified in understanding the "Pepsi Stuff" promotion as a legally binding promise. Put yourself in the position of an in-house attorney for Pepsico reviewing the television ad before it aired. Review the first version of the "Pepsi Stuff" commercial and consider what advice you would have given your client about this ad. Finally, try to develop an argument that would justify holding advertisers responsible for even unreasonable misunderstandings like Leonard's.

You may find it useful to spend a little time reflecting on the distinctive "moves" that we made while discussing objective intent. First, you should have noticed the importance in litigation of developing a powerful factual and legal narrative—your client's "story" of the case. Second, we worked hard to generalize the legal principle underlying each decision so that it could give us insight into similar issues in many other cases. Finally, we used the technique of "flipping the rule" to explore the potential normative justifications for choosing a particular legal rule rather than possible alternatives.

---

### 1.3 Capacity to Contract

In *Lucy*, the court discusses at some length the possibility that Zehmer might be excused from contractual liability because he was intoxicated. The law concerning intoxication is simply one manifestation of a more general principle that we refer to as "capacity to contract." This section of the textbook provides a very brief introduction to the issue of legal capacity.

I've categorized this topic in the "Regulation" group because some aspects of these legal rules impose categorical constraints that limit which parties are able to make enforceable contracts. It is equally valid, however, to see these rules as an outgrowth of a requirement we have already studied. In order to impose contractual liability, a court must find that the parties' manifestations showed an intent to make a "commitment." In each case of incapacity, we can understand the rule as a policy decision that a particular characteristic makes a person incapable of forming the intention to make a legally enforceable promise and thus of expressing the degree of commitment required for a contract.

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Please read sections 12 and 16 of the RESTATEMENT (SECOND) OF CONTRACTS.

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Section 12 of the Restatement (Second) of Contracts limits the contractual capacity of those who are (a) under guardianship, (b) an infant, (c) mentally ill or defective, or (d) intoxicated. Historically, married women also lacked the legal

capacity to make contracts, but statutory reforms have eliminated this vestige of paternalism. The most commonly invoked claims of incapacity involve contracts entered into by minors, by persons who are not mentally competent, and (though only very rarely successful) by those who are intoxicated.

Minors, that is anyone who has not reached the age of majority—usually 18 years old—may create only "voidable" contractual obligations. This rule means that a minor may "disavow" a contract and not be bound to perform. The minor must return any money or property obtained under the contract and may also be required to pay the reasonable value of any "necessaries of life," including food, clothing, shelter, medical care or similar items. In addition, a minor who misrepresents his or her age when entering a contract incurs a duty to restore any value the other party has conferred on the minor. In the event that a minor fails to disavow a contract, it remains in force and may be enforced against both parties. Notice that a person with full contractual capacity who makes a contract with a minor does not have a right to avoid enforcement of the contract unless the minor chooses to disavow it.

A contract with someone who has been adjudged mentally incompetent is void. This rule means that neither party can enforce the contract. In addition, the Restatement makes contractual obligations voidable if mental incapacity causes a person to be unable to understand the nature and consequences of a legal transaction or to act in a reasonable manner in relation to that transaction.

In *Lucy v. Zehmer*, the Virginia Supreme Court applies the incapacity standard for intoxication. Both Zehmer and Lucy were "pretty high" and Zehmer continued to drink after he was "already high as a Georgia pine." As you reread the court's opinion, notice what evidence the court uses to challenge Zehmer's claim that he was too intoxicated to make a contract. Consider also what happens at oral argument on this issue. What does Zehmer's attorney say about his client's claim of incapacity? And why do you think he makes this concession?

The issue of contractual capacity will not arise often in the rest of our cases and discussion. Nevertheless, this is a doctrine worth keeping in the back of your mind as you encounter and analyze contractual situations in the future.

## 1.4 The Law of Agency

Can one person make a contract on behalf of someone else? The answer to this question is clearly yes, but that person needs to have either actual or apparent authority. Your readings and our discussion of agency law will introduce you to both of these legal concepts.

A complex body of law determines who is an “agent” and what that agent is authorized to do on behalf of their “principal.” The Restatement (Third) of Agency includes several provisions that explain the basic legal rules governing when someone has the legal authority to make a contract for another person.

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Please read sections 1.03, 2.01, 2.03, 3.03, and 3.11 of the RESTATEMENT (THIRD) OF AGENCY.

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Although *Bailey v. West* resolves whether the horse farm owner Howard Bailey had a contract with race horse enthusiast Richard West for boarding Bascom's Folly, the case also involves a number of agents and one potential agent. The court sometimes talks about Bailey and West as though they were dealing directly with one another, but, in fact, agents completed the transaction on their behalf. There can be no doubt that Strauss's trainer and West's trainer were acting as agents for their respective employers. More controversially, consider whether there is a plausible argument that Kelly, the van driver, could have been acting as an agent for West in dealing with Bailey.

The body of law on agency relationships is, as a formal matter, external to the law of contracts. However, these legal rules often arise in contract disputes and they affect contract formation in significant ways. Focus on determining when someone has sufficient legal authority to make a contract on behalf of someone else. Please reread *Bailey v. West*, attending this time to the question of whether agency law offers any basis for arguing that Kelly made a boarding contract with Bailey on behalf of West.



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Please reread *Bailey v. West* in your volume of Principal Cases.

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In order to refine your understanding of how agency law affects contractual responsibility, consider the Pig Place hypothetical presented below.

#### **1.4.1 Hypo on Agency**

Paula owns a major national restaurant chain called Pig Place. The chain's staff includes Andrew, the Pig Place purchasing manager. It is Andrew's job to deal with food distributors and farms. He places orders, receives deliveries, handles returns, and approves payment on behalf of the restaurants. Among the suppliers with whom Andrew has regularly done business is Confinement Farms.

During a recent staff meeting, Paula told Andrew she had decided that the chain must no longer purchase any meat raised in inhumane conditions. Accordingly, Paula instructed Andrew to order only products certified by the Organic Growers Council (OGC). She explained that Pig Place would soon begin a major print, radio and television advertising campaign announcing the new policy and touting the health and environmental benefits of treating food animals humanely. Paula expressly instructed Andrew to stop dealing with Confinement Farms because they run a conventional growing and packaging operation that lacks OGC certification.

Andrew ignored Paula's instructions and placed an order for 100,000 pounds of pork from Tom, who is the national sales manager at Confinement. A day later, Pig Place's media campaign began and wholesale meat markets responded with alarm. The price of conventionally raised pork fell by 35 percent. Pig Place wants to cancel the order, but Confinement stands to lose more than \$70,000 if it must resell the pork. Paula has fired Andrew for disregarding her instructions, but Andrew can't afford to pay for the decline in the value of the meat.

*Questions for discussion:*

As between Pig Place and Confinement, who should bear the loss? Can you think of any arguments that would justify imposing the loss on Pig Place? On Confinement?

Now consider how the Restatement rules on agency might apply. Did Andrew have actual authority to act on Pig Place's behalf? Is this a proper case for applying the doctrine of apparent authority?

How might the choice of a legal rule affect the behavior of similar parties in the future? Does thinking about these prospective effects provide any justification for choosing one rule rather than another?

### **1.4.2 Problem on Agency**

How do these agency rules apply to the situation in *Bailey v. West*? Is there a plausible argument based on agency law that supports finding that West should be obliged to pay for boarding Bascom's Folly? If so, who is the agent or other actor who has the legal authority to act on behalf of whom? Can you also develop agency law arguments that tend to excuse West from any obligation to Bailey?

\* \* \*

As you read other cases, think about whether they involve principals acting on their own behalf. Quite commonly, you will find that agents negotiate and execute contracts on behalf of their principals. Managerial and executive employees, for example, routinely make contracts on behalf of corporate employers. Less frequently, cases may involve other types of agents such as attorneys, realtors, and insurance brokers. In your own contractual negotiations, it is wise to be sure that you are dealing with someone who has the requisite authority to bind their principal.

### **1.5 The Law of Restitution**

Although we have already discussed the implied-in-fact contract claim and the potential agency law issues the case implicates, we're not quite finished mining interesting legal issues from *Bailey v. West*. After rejecting Bailey's implied contract claim, the *Bailey* court also considers whether West should be bound to pay Bailey for boarding services under "a quasi-contractual theory." Paragraphs 13 to 19 of the court's opinion discuss and reject Bailey's argument for quasi-contract.

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Please reread the relevant portion of *Bailey v. West*  
in your volume of Principal Cases.

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Technically, quasi-contract is one type of recovery in “restitution.” However, modern commentators have largely abandoned the term “quasi-contract” and instead analyze such claims under the law of restitution. Most people today would simply say that Bailey was seeking restitution for the value of the boarding services he provided. Many modern courts and the recently published Restatement (Third) of Restitution refer to this type of claim as one for “unjust enrichment.” Note also that, in paragraph 17, the *Bailey* court cites the first Restatement of Restitution for the legal principles it uses to reject Bailey's claim.

It is important to distinguish restitution as a theory of liability from contract remedies that seek to protect a promisee's “restitution interest.” Although a bit confusing, you should be able to determine from the context which doctrine a court or litigant is invoking. If the case involves an enforceable contract and the legal question is what remedy to award for a breach of that contract, then the *remedial* concept of restitution will control. You will also encounter cases involving intentional torts and misuse of intellectual property where courts award restitution (or disgorgement) damages in the amount of any profit the defendant has earned as a result of their wrongdoing.

In a case like *Bailey*, however, the question the court considers under the rubric of “quasi-contract” is whether West can be held liable for the cost of boarding Bascom's Folly in the absence of an enforceable contract. Thus, that case involves a claim for restitution as a theory of *liability*.

Some of the most common cases in which courts use the principles of restitution to establish liability are probably those involving mistaken payments and emergency care. In the first category, for example, A unknowingly pays B money for a debt that is really owed to C. Restitution allows A to recover the erroneous payment from B. In the second category, imagine that a physician treats an unconscious patient in an emergency. Restitution allows the doctor to recover for the reasonable value of the care she has provided. A third category of cases arises when courts refuse (under the indefiniteness doctrine that we will soon study) to enforce a promise to pay for work because the promise is too vague or uncertain. These same courts may then use

the doctrine of "quantum meruit" to give a recovery in restitution for the value of any services performed under the unenforceable contract. There are other cases to be sure, but these three examples should give you an intuitive understanding of how this theory of liability works.

Our goal in this section is to give you some experience applying restitution doctrine to cases involving the provision of services and to uncover the policy considerations that underlie these legal rules. Our theoretical analysis will help us to predict case results and understand what justifies courts' reluctance to allow restitutionary recovery outside of a few clearly defined circumstances.

Courts ordinarily refuse to provide compensation without evidence of a bargain. They often characterize the unsuccessful claimant as a "mere volunteer" or even perhaps an "officious intermeddler." In very limited circumstances, however, courts may be willing to impose liability on someone who receives a benefit for which they have not bargained. An oft-quoted example is the following hypothetical from a judicial opinion:

If a person saw day after day a laborer at work in his field doing services which must of necessity enure to his benefit, knowing that the laborer expected pay for his work, when it was perfectly easy to notify him his services were not wanted, even if a request were not expressly proved, such a request, either previous or contemporaneous with the performance of the services might fairly be inferred. But if the fact was merely brought to his attention upon a single occasion and casually, if he had little opportunity to notify the other that he did not desire the work and should not pay for it, or could only do so at the expense of much time and trouble, the same inference might not be made.

*Day v. Caton*, 119 Mass. 513 (1876) (Holmes, J.).

Consider the following hypothetical on restitution involving Bob the Builder.

### 1.5.1 Hypo on Restitution

Bob (the Builder) runs a construction company. A farmer hires Bob to demolish a ramshackle barn and erect in its place a prefabricated metal shed. The farmer agrees to pay the standard price for the shed and to allow Bob to sell any lumber he can salvage from the old barn. Unfortunately, Bob loses the scrap of paper on which he had written the directions to the farm. He recalls, however, that the farm is located just west of the intersection between Owensville and Garth Roads.

Relying on Google Maps and his recollection of the directions, Bob quickly finds a decrepit barn and spends the next week completing the demolition and shed construction. Bob also notices that a fence on the neighboring property is in disrepair. He decides to use the lumber salvaged from the barn to fix the fence.

When Bob calls the farmer to collect his bill, he discovers to his chagrin that there were several old barns in the immediate area. The new shed stands on land owned by Randle, a retired investment banker. Randle had spent every afternoon of the previous week sipping martinis on his back porch while he watched Bob at work on his barn. The fence owner, Jane, spent the week vacationing in Europe. Both Randle and Jane are delighted with Bob's work but they each refuse to pay.

Suppose that Bob seeks restitution from Randle and Jane. Who do you expect will win and why? Suppose that Bob had instead demolished a barn and built the shed on Jane's land. Would Bob have a better or worse chance of recovery against Jane?

#### *Questions for discussion:*

Do the "essential elements of quasi-contract" discussed in *Bailey v. West* help us to determine whether Bob will prevail against Randle or Jane?

Consider how a rule denying Bob compensation will affect the behavior of future contractors and other homeowners. What would happen if we were to flip the rule and allow Bob to recover against both of the lucky homeowners?

Does Bailey have any argument for restitutionary recovery from West?

Can you see any connection between the principles that govern the implied contract claim in *Bailey v. West*, the agency issue, and the rules for restitution?

\* \* \*

Be certain that you understand the difference between restitution as a theory of liability and restitution as a remedy. Reflect on our discussion about what justifies courts' reluctance to expand the cause of action for restitution. Finally, try to bear in mind our discovery that, as applied to our hypothetical, the formal doctrinal rule reduces to an amorphous inquiry into whether equity demands compensation. We will make similar discoveries about other formal rules later in these materials.

## **2. Which Promises Are Enforced?**

Now that we have a better understanding of how courts determine whether someone has made a promise, we can consider which promises are enforced and why. As we will see, doctrines such as indefiniteness and consideration prevent enforcement of some seriously intended promises. But first consider whether there are any influences other than legal enforcement that tend to encourage people to keep their promises.

### **2.1 Why Enforce Promises?**

#### **2.1.1 Alternative Methods of Enforcement**

Imagine that you are the proprietor of a specialty auto parts manufacturer. You sell your products to retailers who in turn sell them to car fanciers who use them to customize their rides. What would you do if a production problem threatened your ability to make timely deliveries of a hot new rear spoiler? For example, you might have to decide whether to incur added costs for overtime hours and for expedited delivery of raw materials. Presume for the moment that litigation costs will prevent retailers from suing you for breach.

What factors will affect your choice about these additional expenses? Are there any extra-legal enforcement mechanisms that might lead you to exert yourself to restore supply quickly despite the absence of any effective legal sanction for breach?

Yet another way to shed light on the role of legal enforcement is to examine the problem of instantly retracted promises.

### 2.1.2 Hypo on Instant Retraction

Suppose that, disappointed with the result in *Bailey v. West*, poor Mr. Bailey decides to get out of the horse farm business. One morning, he mournfully signs a written agreement to sell his farm to a neighbor and long-time competitor. He walks outside and runs into a dear old friend who convinces him that he should continue in business. Bailey rushes back inside to tell the neighbor that the deal is off, but the neighbor insists that they have a deal. Bailey subsequently refuses to convey the farm.

*Questions for discussion:*

What do you suppose happens when the neighbor sues Bailey for the farm?

One possible argument against enforcement in this hypothetical is that it would be inefficient to force Bailey to turn over the farm. He must value the farm more highly than the neighbor because he is willing to give up the purchase price in order to keep it.

Can you see any problems with this reasoning? What exactly does Bailey's decision tell us about his valuation of the farm in comparison with the neighbor's valuation of the property?

Another argument is that we enforce promises in order to protect beneficial reliance and to reduce detrimental reliance. Thus, we shouldn't enforce this instantly retracted promise because the neighbor has not yet relied on the promise.

What would you expect to happen if courts adopted a rule that conditioned enforcement on proof of reliance?

Consider how the parties in our hypothetical might try to prove or disprove reliance.

Would future parties behave any differently in reaction to such a rule? In other words, what are the likely "prospective effects" of a legal rule permitting instant retraction?

### **2.1.3 Gap Filling**

A moment's thought will reveal that it is impossible to write a complete contract. No contract can possibly deal with every contingency, with every state of the world that might occur, with every change of circumstances that might affect the parties' willingness and ability to perform the duties they have promised to perform. Indeed, the possibilities are infinite and our time and resources for anticipating situations and drafting appropriate provisions are decidedly finite. Thus, we inevitably draft incomplete contracts.

One important function of contract law is, therefore, to fill the gaps in these incomplete agreements. We will refer to these court-supplied terms as contract "default rules." Like the default settings in a word processing program for font size, margins, and line spacing, contract defaults apply unless the parties make a contrary agreement.

In order to begin to understand the role of defaults, consider the following hypothetical.

### **2.1.4 Hypo on Gap Filling**

My colleague Paul Mahoney and I agree that I will lease his car for a year while he is on leave to establish a new law office in Russia. We explicitly agree on a rental rate of \$100/month and a lease term of one year.

Suppose that the car's clutch fails six months into the lease. How would you expect a court to respond to my claim that Mahoney is obligated to pay for the necessary repairs?

*Questions for discussion:*

We can array various approaches to gap filling along a continuum. At one extreme are simple majoritarian default rules, a one-size-fits-all solution. At the opposite extreme is a highly tailored default term that tries to capture what these particular parties would have agreed to if they had bargained over the issue.

What would be a good majoritarian rule for the car lease hypothetical?



How would a court decide on a tailored default for the same situation?

Which approach to gap filling do you favor? Why?

Can you think of any problems that courts or parties might encounter under your preferred approach?

## **2.2 Introduction to Indefiniteness Doctrine**

As we have discussed, contractual liability requires at least some evidence that a party intended to make a legally enforceable promise. We also have seen that all contracts are necessarily incomplete and that courts create default rules to fill in these inevitable gaps. Indeed, supplying omitted terms is a central function of contract law. However, the question remains how far courts should go to remedy contractual incompleteness. Perhaps there should be certain essential terms that the parties themselves must specify in order to form a contract.

As a matter of fact, courts sometimes refuse to enforce even seriously intended promises. Why would that be? Indefiniteness doctrine provides an answer. Sometimes contractual gaps are simply too large and a court must refuse enforcement. However, judicial approaches to indefiniteness vary considerably.

The “indefiniteness” doctrine refers to a legal conclusion that a purported contract contains too many gaps to warrant enforcement. We will explore two competing reasons for refusing to enforce indefinite agreements. First, a court might believe that gaps in an agreement are so fundamental they indicate that the parties lacked the requisite *intent to contract*. Courts frequently rely on this intent-based reasoning to refuse to enforce so-called “agreements to agree.” Suppose, for example, that Sam tells Wanda that he’ll accept a management position at her high-tech startup company for “a salary to be determined by future negotiations between the parties.” If the parties are subsequently unable to agree on a salary, courts ordinarily will refuse to find an enforceable employment contract. Sam and Wanda’s failure to agree on this important contract term shows that they did not intend to be bound to a legally enforceable agreement.

The second argument for refusing to enforce indefinite agreements proceeds on the assumption that the parties intended to form an enforceable contract. Courts taking this approach focus on concerns about judicial capacity and the parties’ *lack of*

*care in drafting*. For example, in *Walker v. Keith*, 382 S.W.2d 198 (Ky. Ct. App. 1964), the court explained that:

Stipulations such as the one before us have been the source of interminable litigation. Courts are called upon not to enforce an agreement or to determine what the agreement was, but to write their own concept of what would constitute a proper one. Why this paternalistic task should be undertaken is difficult to understand when the parties could so easily provide any number of workable methods by which rents could be adjusted. As a practical matter, courts sometimes must assert their right not to be imposed upon.

We will see that some courts are concerned principally, or even exclusively, with whether the parties intended to form a legally binding contract. Other decisions refusing to enforce indefinite promises chide the parties for their imprecision and lack of diligence in drafting. Courts in different jurisdictions also may vary, with some being more restrictive and others more permissive about indefinite agreements. Finally, you should be alert for differences between common law and statutory approaches to this issue.

As you read the indefiniteness cases that follow (*Varney*, *Corthell*, *D.R. Curtis*, and *Schumacher*), try to determine what judgment underlies the court's decision to refuse enforcement.

### **2.3 *Varney v. Ditmars***

Our first principal case on the indefiniteness doctrine requires very close reading. As you will see, the majority and “dissenting” opinions approach the problem from decidedly different theoretical perspectives.

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Please read *Varney v. Ditmars* in your volume of Principal Cases.

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*Questions for discussion:*

What terms in *Varney's* employment agreement are uncertain?

What is the basis for Justice Cardozo's "dissent"? Does he agree or disagree with the majority's ruling on a "fair share of profits"?

Do you see any evidence that the court doubts the parties intended to form a contract?

Is there any hint of the drafting concern?

What is the basis for the many cases cited by the majority? Can you tell by reading the court's description of those cases whether they rest on doubt about the parties' intent to contract or instead on defects in their contractual drafting?

### **2.3.1 Note on *Corthell v. Summit Thread Co.***

In *Corthell v. Summit Thread Co.*, 132 Me. 94 (1933), an employee promised to turn over future inventions in return for "reasonable recognition" from his employer. A written agreement provided that "the basis and amount of recognition [shall] rest entirely with Summit Thread Company at all times ... to be interpreted in good faith on the basis of what is reasonable and not technically." In upholding the enforceability of this agreement, the court said:

There is no more settled rule of law applicable to actions based on contracts than that an agreement, in order to be binding, must be sufficiently definite to enable the Court to determine its exact meaning and fix exactly the legal liability of the parties. Indefiniteness may relate to the time of performance, the price to be paid, work to be done, property to be transferred or other miscellaneous stipulations of the agreement. If the contract makes no statement as to the price to be paid, the law invokes the standard of reasonableness, and the fair value of the services or property is recoverable. If the terms of the agreement are uncertain as to price, but exclude the supposition that a reasonable price was intended, no contract can arise. ... [T]he contract of the parties indicates that they both promised with "contractual intent," the one intending to pay and the other to accept a fair price for the inventions turned over. "Reasonable recognition" seems to have meant what was fair and just between the parties, that is, reasonable compensation.

*Id.* at 99.

### **2.3.2 Reconciling *Varney* and *Corthell***

Is it possible to reconcile the holdings of *Varney* and *Corthell*?

What might explain the differences between the courts' reaction to language that appears equally vague in the two agreements?

\* \* \*

Our close reading of the majority opinion and Judge Cardozo's opinion in *Varney* reveals that judicial opinions have multiple layers. We can refer to a case simply for its holding. The accumulation of many such decisions establishes the so-called "black letter law" on any legal issue. We may also probe more deeply to uncover the court's reasoning. Doing so allows attorneys to appreciate subtler nuances of the law and to make more sophisticated legal arguments for their clients.

Moving beyond a single case, we can develop "descriptive theories" to help us understand how one decision relates to others. This analysis in turn may point the way to a "predictive theory" that improves the ability of a practitioner to anticipate how future cases will be decided. Finally, we use "normative theory" (aka "prescriptive theory") to analyze whether a particular rule or pattern of decisions can be justified.

I encourage you to reflect on the issues we have studied so far and see if you can distinguish when we have been operating at which level of analysis. As you continue to read cases and use them in legal arguments, it will be helpful to think carefully about which analytic approach best serves your current purpose.

## **2.4 Sources of Contract Law**

Our discussion to this point has focused on what is known as the common law of contracts. Originating in judge-made English common law, the U.S. common law has developed and in some respects diverged from the English model in the two centuries since independence. The only fully authoritative statement of common law rules are the judicial decisions applying those rules. However, the American Law Institute (ALI) – a prestigious organization of prominent attorneys, judges and

academics – has periodically published a Restatement of the Law of Contracts and of other subjects such as torts, agency law, etc. The most recent edition for contracts, the Restatement (Second), was completed in 1979. Though formally non-binding, the Restatement exerts a powerful influence on judges throughout the country and provides attorneys with a valuable compendium of prevailing legal doctrines.

In addition to the common law, it is also essential for a contemporary contracts lawyer to be knowledgeable about the Uniform Commercial Code (“the UCC” or “the Code”). The UCC was originally drafted as a joint project of the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the ALI. These organizations offered the UCC to the states for adoption and every state has since enacted legislation largely incorporating the provisions of Article 2 concerning the sale of goods.

The driving force and principal architect of the Code was Professor Karl Llewellyn. He sought to modernize and update the law by encouraging courts to discover the commercial norms that he thought were imminent in each transaction and industry. As a result, UCC provisions often make legal rules depend on determining what is “reasonable” in the circumstances. Thus, we have provisions that refer to a “reasonable price,” to a “reasonable time for delivery,” and to “reasonable limitations of damages.” One challenge for students and practitioners is to give content to these apparently amorphous concepts.

For the purposes of our study of contract law, we need only be concerned with Article 2, which defines its coverage in § 2-102:

Unless the context otherwise requires, this Article applies to transactions in goods; it does not apply to any transaction which although in the form of an unconditional contract to sell or present sale is intended to operate only as a security transaction nor does this Article impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers.

The application of the UCC thus depends crucially on the meaning of the term “goods,” which § 2-103(1)(k) defines as follows:

"Goods" means all things that are movable at the time of identification to a contract for sale. The term includes future goods, specially

manufactured goods, the unborn young of animals, growing crops, and other identified things attached to realty as described in Section 2-107. The term does not include information, the money in which the price is to be paid, investment securities under Article 8, the subject matter of foreign exchange transactions, or choses in action.

Section 2-107 elaborates on the coverage of goods to be severed from realty:

(1) A contract for the sale of minerals or the like (including oil and gas) or a structure or its materials to be removed from realty is a contract for the sale of goods within this Article if they are to be severed by the seller but until severance a purported present sale thereof which is not effective as a transfer of an interest in land is effective only as a contract to sell.

(2) A contract for the sale apart from the land of growing crops or other things attached to realty and capable of severance without material harm thereto but not described in subsection (1) or of timber to be cut is a contract for the sale of goods within this Article whether the subject matter is to be severed by the buyer or by the seller even though it forms part of the realty at the time of contracting, and the parties can by identification effect a present sale before severance.

(3) The provisions of this section are subject to any third party rights provided by the law relating to realty records, and the contract for sale may be executed and recorded as a document transferring an interest in land and shall then constitute notice to third parties of the buyer's rights under the contract for sale.

It is important to understand that the statutory provisions of the UCC take precedence over the common law for transactions in goods. Thus, when goods are involved your first thought should be to determine whether there is an applicable Code provision. If no statutory provision addresses the issue, then you should resort to the background principles of the common law of contracts. In contrast, the UCC is inapplicable to transactions that do not involve goods. The most common examples are contracts for services, real estate, and intangible rights such as intellectual property.

## 2.5 *D.R. Curtis Co. v. Mathews*

Now try applying your developing understanding of indefiniteness doctrine to the following case.

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Please read *D.R. Curtis Co. v. Mathews* in your volume of Principal Cases.

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### 2.5.1 Note on *Joseph Martin, Jr., Delicatessen, Inc. v. Schumacher*

In *Joseph Martin, Jr., Delicatessen, Inc. v. Schumacher*, 52 N.Y.2d 105 (1981), the parties executed a real estate lease containing an option to renew at a price to be agreed upon. The renewal clause provided that the “Tenant may renew this lease for an additional period of five years at annual rentals to be agreed upon; Tenant shall give Landlord thirty (30) days written notice, to be mailed certified mail, return receipt requested, of the intention to exercise such right.”

The tenant sought to exercise this option but the landlord demanded a rental rate for renewal of \$900 per month, far in excess of the \$650 rate provided for the final year of the original lease. The tenant sued to compel the landlord to extend the lease at a “reasonable rate” or “fair market value.” Although a lower court granted the tenant specific performance at a “fair” rent, the appellate court reversed.

The court invoked a widely applied rule that a mere “agreement to agree, in which a material term is left for future negotiations, is unenforceable.” In the court’s view, it takes at least some evidence of an agreement on all material terms before a court can step in to resolve any contractual ambiguity. An agreement to agree demonstrates to the contrary that the parties were unable to reach an agreement on that term.

*Questions for discussion of D.R. Curtis and Schumacher:*

Suppose that *D.R. Curtis* had involved an agreement to rent real estate or provide services rather than a contract for the sale of goods. Would the deal be enforceable?

Does *Schumacher* have anything to teach us about this question?

Why does the contract for the sale of goods in this case end up being enforced?

In this connection, consider the following provisions of the Uniform Commercial Code (UCC).

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Please read sections 2-204 and 2-305 of the UCC.

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### **2.5.2 Problem: Price vs. Quantity Under the UCC**

As we have seen, the Code allows a court to supply a “reasonable price” when it determines that the parties intended to have an enforceable agreement but omitted or failed to agree on a price. *See* UCC § 2-305. Similarly, the Code supplies “reasonable” judge-made defaults for many other missing terms in an agreement. A curious puzzle, however, is that the UCC contains no provision for supplying a “reasonable quantity” when the parties fail to specify one. Moreover, in a section concerned with the formal requirements for enforcing certain contracts, the Code expressly provides that a “contract is not enforceable under this subsection beyond the quantity of good shown in the writing.” *See* UCC § 2-201.

Try to develop an explanation for this disparate treatment of quantity and price (along with other terms). Why does the Code appear so willing to supply a missing price term and simultaneously reluctant to enforce a contract that omits the quantity?

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View the screencast videos on Indefiniteness: [Part One](#), [Part Two](#), and [Part Three](#).

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## **II. THE CONSIDERATION REQUIREMENT AND ALTERNATIVES**

We began by asking whether the parties have made a promise. Did West give Bailey sufficient reason to believe that he wished to board Bascom's Folly at Bailey's farm? Was Lucy justified in taking seriously Zehmer's decision to sign the contract for the sale of the Ferguson Farm? Our two most recent principal cases explored whether some promises are simply too indefinite to be enforced. Either the parties had no intention of being contractually bound, or the purported contract gives the court too little information to be able to discern the substance of the parties' agreement.

In this chapter, we will examine the doctrines that determine whether courts will enforce even reasonably definite promises.

### **1. Consideration Doctrine**

In addition to requiring that parties demonstrate an objective intent to contract, courts also impose an additional requirement of "consideration" to support an enforceable promise. Although this doctrine may at first seem a bit peculiar, our readings and discussions will illuminate both the older "benefit or detriment" approach and the modern "bargain theory" of consideration contained in § 71 of the Restatement. As you read these materials, try to distinguish these different approaches and think about how they might be related to one another.

Begin by reading the following Restatement provisions concerning consideration doctrine:

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Please read sections 17 and 71 of the RESTATEMENT (SECOND) OF CONTRACTS.

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The Restatement defines consideration in terms of exchange, and, with the exceptions noted in § 17(2), requires that a promise be supported by consideration in order to be legally enforceable. Professor Stanley Henderson has offered the following explanation for this doctrinal requirement.

The essential function of consideration is to determine the types of promises which should not be enforced. The promise which does not purport to exact an exchange is singled out by consideration doctrine as the one least worthy of enforcement, because it may well have been given without the care which an exchange relationship encourages and because it is least likely to serve a useful economic function.

Stanley D. Henderson, *Promissory Estoppel and the Traditional Contract Doctrine*, 78 YALE L.J. 343, 346 (1969). Although we will focus on the Restatement's formulation of the consideration doctrine, you should also be aware that many older decisions instead analyze consideration as a benefit to the promisor or a detriment to the promisee. In our discussion of *Hamer v. Sidway*, we will try to reconcile these two distinct ways of talking about consideration.

## 1.1 *Hamer v. Sidway*

The court in *Hamer v. Sidway* decided to enforce a deceased, rich uncle's generous promise to reward his nephew for abstaining from certain vices. As you read, consider precisely what facts made the uncle's promise enforceable.

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Please read *Hamer v. Sidway* in your volume of Principal Cases.

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### 1.1.1 The Benefit-Detriment Test

We have seen that Restatement § 71 frames consideration in terms of bargain and exchange. Here is how one court reconciled this modern formulation with the traditional discussion of benefits and detriments.

The words "benefit" and "detriment" in contract cases involving consideration have technical meanings. "Detriment" as used in determining the sufficiency of consideration to support a contract means "'legal detriment' as distinguished from detriment in fact. It means giving up something which immediately prior thereto the promisee was privileged to retain, or doing or refraining from doing

something which he was then privileged not to do, or not to refrain from doing.” (Hamilton Bancshares, Inc. v. Leroy (1985), 131 Ill. App. 3d 907, 913, quoting 1 Willison, Contracts § 102A, at 380-382 (3d ed. 1957).) For example, a promise to give up smoking is also a legal detriment and sufficient consideration to support a contract.

*Davies v. Martel Laboratory Services, Inc.*, 545 N.E.2d 475, 477 (Ill. App. 1989).

### **1.1.2 Consideration and Motive**

It may be tempting to focus on a party’s motive for acting in determining whether an act can or cannot serve as consideration. The following excerpt from OLIVER WENDELL HOLMES, *THE COMMON LAW* 293-94 (1887) describes a more subtle role for motive.

It is said that consideration must not be confounded with motive. It is true that it must not be confounded with what may be the prevailing or chief motive in actual fact. A man may promise to paint a picture for five hundred dollars, while his chief motive may be a desire for fame. A consideration may be given and accepted, in fact, solely for the purpose of making a promise binding. But, nevertheless, it is the essence of consideration, that, by the terms of the agreement, it is given and accepted as the motive or inducement of the promise. Conversely, the promise must be made and accepted as the conventional motive or inducement for furnishing the consideration. The root of the whole matter is the relation of reciprocal conventional inducement, each for the other between consideration and promise.

*Questions for discussion of Hamer v. Sidway:*

Why does Uncle William’s executor resist paying Willie the \$5,000 plus interest? What is the estate’s argument against enforcement of this promise?

Notice that the court discussed consideration in terms of benefits and detriments. Under this traditional understanding of the doctrine, why does the plaintiff prevail?

Now consider the modern definition of consideration in Restatement § 71. How would the plaintiff argue for enforcement under this version of the doctrine?

## 1.2 *St. Peter v. Pioneer Theatre*

In the following case, as in *Hamer*, the court chooses to enforce a promise. Try to decide whether the court's rationale for enforcement in *St. Peter v. Pioneer Theatre* differs from the reasoning in *Hamer*. Also notice that the court's opinion exemplifies the sort of tedious legal writing that you should strive not to emulate in your own writing.

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Please read *St. Peter v. Pioneer Theatre Corp* in your volume of Principal Cases.

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### 1.2.1 The Legality of “Bank Nights” in Iowa

In *State v. Hundling*, discussed in *St. Peter v. Pioneer Theatre*, the Iowa Supreme Court held that participants in a Bank Night contest had not given valuable consideration within the meaning of the state's criminal statute prohibiting lotteries. Several decades later, the same court reversed itself and ruled that Bank Nights violated Iowa lottery laws. For a detailed history of the Bank Night litigation, see Annotation, 103 A.L.R. 866; 109 A.L.R. 709; 113 A.L.R. 1121.

*Questions for discussion of St. Peter v. Pioneer Theatre:*

Is the alleged contract in this case bilateral or unilateral? What do you suppose that those terms mean?

How would you apply the bargain theory of consideration to the facts of *St. Peter v. Pioneer Theatre*?

Consider whether there is anything fishy about Pioneer Theatre's arguments. Do you see any problem with the theatre arguing that the promotional scheme is not an illegal lottery for the purposes of criminal law while simultaneously maintaining

that, as a matter of contract law, the Bank Night prize is merely an unenforceable promise to give a gift?

### 1.2.2 Problem on Consideration

Consider the following variation on *Hamer v. Sidway*:

Suppose that New York state law made it illegal for Willie to drink, smoke or gamble before the age of 21. Uncle William offers, and Willie accepts, \$5,000 to abstain from these vices until age 21.

Would this promise be enforceable under the language of the *Hamer* decision?

What about under the principles of Restatement § 71?

Can you think of any reason(s) that a court might be reluctant to enforce Uncle William's promise in these circumstances?

Suppose now that the agreement concerns armed robbery and homicide instead. New York state law makes it illegal to commit armed robbery or homicide. Uncle William offers, and Willie accepts, \$5,000 to abstain from armed robbery and homicide until age 21.

How would you expect a court to analyze this promise?

---

### *Peer Editing Exercise for the Problem on Consideration*

To help you become more conscious of the choices that you must make in writing essay answers of this type, prepare a written response to this problem. Provide printed copies of your answer to your classmates. As you read your classmates' work, ask yourself the following questions:

1. Is the writing clear and to the point, avoiding convoluted syntax, awkward word choice, and unnecessary jargon?
2. Does the argument have a coherent structure, organized logically and progressing smoothly through each part of the analysis?

3. Does the answer use the given facts effectively to determine the most likely legal outcome?
4. Does the author select the correct legal rules and/or predictive theories and analyze thoroughly how those rules and theories apply to the given facts?
5. Does the author indicate which arguments are stronger and which ones are weaker and do they spend the most time and space on the strongest arguments about the most difficult issues?
6. Is there a definite and thoughtful conclusion that signals clearly the author's degree of confidence in that conclusion?
7. Does the answer display any creative thinking or unusual rhetorical strength?

Now write your name on the top of the printed answer and write your comments about the answer. It is usually best to start with what you see as strengths of the answer. Then explain any problems you can find.

Feel free to use the numbers of the questions above as shorthand for that issue (e.g., "2-easy to follow the logic of your argument, 6-can't tell how certain you are about the outcome, 7-loved the clever way you compared case X to case Y").

Next, return these marked up answers to their authors. Take a few minutes to read and discuss the comments. Try to reach a consensus about the basic outlines of a good answer.

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## **2. Bargain or Gift?**

Our analysis of consideration has thus far introduced the benefit-detriment test used in *Hamer v. Sidway* as well as the more modern bargain theory of consideration, which is described in Restatement § 71 and applied in *St. Peter v. Pioneer Theatre*. We have also explored the relationship between these two versions of consideration doctrine. When parties feel the need to bargain, it is ordinarily because they each hope to obtain a benefit that the other party regards as a detriment. Thus, the

existence of a bargain usually implies the existence of both a benefit to the promisor and a detriment for the promisee.

The cases that follow will allow us to refine our understanding of the rules concerning consideration. As we will see, consideration doctrine polices the line between enforceable bargains and unenforceable promises to make gifts. Consideration also can be understood as a legal formality.

Professor Lon Fuller proposed that consideration doctrine serves four important objectives: an evidentiary function, a cautionary function, a deterrent function and a channeling function. *See* Lon Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799, 800-802 (1941). According to Fuller, satisfying the formal requirement of consideration provides evidentiary assurance about the existence of an agreement. This legal formality also has the potential to check rash or impulsive action and prevent parties from assuming legally enforceable obligations without sufficient deliberation. Finally, the consideration requirement allows parties to choose a legally binding form for certain important promises. Fuller sought to explain this final channeling function of legal formalities with an analogy to the use of language.

One who wishes to communicate his thoughts to others must force the raw material of meaning into defined and recognizable channels; he must reduce the fleeting entities of wordless thought to the patterns of conventional speech. One planning a legal transaction faces a similar problem. His mind first conceives an economic or sentimental objective, or, more usually, a set of overlapping objectives. He must then, with or without the aid of a lawyer, cast about for the legal transaction (written memorandum, sealed contract, lease, conveyance of the fee, etc.) which will most nearly accomplish all these objectives. Just as the use of language contains dangers for the uninitiated, so legal forms are safe only in the hands of those who are familiar with their effect ....

*Id.* at 801.

## 2.1 *Kirksey v. Kirksey*

We begin with a short and somewhat mysterious case involving a relative's promise to give a widow a comfortable place to live.

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Please read *Kirksey v. Kirksey* in your volume of Principal Cases.

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### 2.1.1 The Law of Gifts

The court in *Kirksey* concluded that Isaac Kirksey's promise to give his sister-in-law a place to live was "a mere gratuity." Here is what another court had to say about what a donor must do to make a gift enforceable:

A gift is a contract without valid consideration, and, to be valid, must be executed. A valid gift is therefore a contract executed. It is to be executed by the actual delivery by the donor to the donee, or to someone for him, of the thing given or by the delivery of the means of obtaining the subject of the gift, without further act of the donor to enable the donee to reduce it to his possession. "The intention to give must be accompanied by a delivery, and the delivery must be made with the intention to give." Otherwise there is only an intention or promise to give, which, being gratuitous, would be a mere nullity. Delivery of possession of the thing given, or of the means of obtaining it so as to make the disposal of it irrevocable, is indispensable to a valid gift.

*Spooner's Administrator v. Hilbish's Executor*, 23 S.E. 751, 753 (Va. 1895).

### 2.1.2 Williston's Tramp and Conditional Gifts

It is something of a puzzle in *Kirksey* that the trouble and inconvenience Antillico suffered in moving her family was not sufficient consideration to support her brother-in-law's promise. Resolving this puzzle requires us to determine whether what Antillico did was the price of a bargain with Isaac or merely a condition



precedent to receiving a gift. Professor Samuel Williston used the following hypothetical to distinguish contractual consideration from a conditional gift:

If a benevolent man says to a tramp: “If you go around the corner to the clothing shop there, you may purchase an overcoat on my credit,” no reasonable person would understand that the short walk was requested as consideration for the promise, but that in the event of the tramp going to the shop the promisor would make him a gift. Yet the walk to the shop is in its nature capable of being consideration. It is a legal detriment to the tramp to make the walk, and the only reason why the walk is not consideration is because on a reasonable construction it must be held that the walk was not requested as the price of the promise, but was merely a condition of a gratuitous promise. It is often difficult to determine whether words of condition in a promise indicate a request for consideration or state a mere condition in a gratuitous promise. An aid, though not a conclusive test in determining which construction of the promise is more reasonable is an inquiry whether the happening of the condition will be a benefit to the promisor. If so, it is a fair inference that the happening was requested as a consideration. On the other hand, if, as in the case of the tramp stated above, the happening of the condition will be not only of no benefit to the promisor but is obviously merely for the purpose of enabling the promisee to receive a gift, the happening of the event on which the promise is conditional, though brought about by the promisee in reliance on the promise, will not properly be construed as consideration. In case of doubt where the promisee has incurred a detriment on the faith of the promise, courts will naturally be loath to regard the promise as a mere gratuity and the detriment incurred as merely a condition. But in some cases it is so clear that a conditional promise was intended even though the promisee has incurred a detriment, the promise has been held unenforceable.

1 SAMUEL WILLISTON, THE LAW OF CONTRACTS § 112 (1922).

### 2.1.3 The Story of *Kirksey v. Kirksey*

Some commentators have suggested that perhaps Isaac Kirksey had romantic designs on his widowed sister-in-law and only evicted her when the relationship soured. Others have argued that he sought financial rather than romantic advantage by inviting her to live with him.

Isaac Kirksey ... had an ulterior motive. He meant to place Antillico on public land to hold his place ... so that he could buy the land from the U.S. government at a lucrative discount. ... Isaac evicted Antillico because a change in the laws made Isaac ineligible to buy [the land] at a discount, but the same law allowed Antillico a right to the land on which Isaac placed her.... Only by evicting her could Isaac hope to retain that land.

William R. Castro & Val D. Ricks, “*Dear Sister Antillico ...*” *The Story of Kirksey v. Kirksey*, 94 GEO. L.J. 321, 323-25 (2006).

*Questions for discussion of Kirksey v. Kirksey:*

How do you make a gift enforceable? Is a promise enough? Why is the offer of an overcoat to Williston’s tramp merely a conditional gift? Can you apply the same analysis to *Kirksey*?

Is there any plausible interpretation of the facts in *Kirksey* that would supply evidence of consideration to support Isaac’s promise?

### 2.2 *In re Greene*

Our next principal case presents a situation in which we can be quite certain the parties intended to form a legally enforceable contract. As you read, consider what evidence makes that intention clear and why the court nevertheless refuses to enforce Mr. Greene’s promises.

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Please read *In re Greene* in your volume of Principal Cases.

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### 2.2.1 The Use of Sealed Contracts

A wax “seal” was an ancient device used to identify the maker of a document and to verify its authenticity. As the following excerpt reveals, this legal formality has lost the power it once had:

Given that unrelieved-upon donative promises are normally unenforceable, the question arises whether the law should recognize some special form through which a promisor with the special intent to be legally bound could achieve that objective. “It is something,” said Williston, “that a person ought to be able ... if he wishes to do it ... to create a legal obligation to make a gift. Why not? ... I don’t see why a man should not be able to make himself liable if he wishes to do so.”

At early common law the seal served this purpose. In modern times, most state legislatures have either abolished the distinction between sealed and unsealed promises, abolished the use of a seal in contracts, or otherwise limited the seal’s effect. The axiomatic school, however, never rejected the rule that a seal makes a promise enforceable, and that rule is now embodied in § 95(1)(a) of the Restatement Second, which provides that “[i]n the absence of statute a promise is binding without consideration if ... it is in writing and sealed ....”

The Restatement Second makes no attempt to justify this rule. Originally, the seal was a natural formality—that is, a promissory form popularly understood to carry legal significance—which ensured both deliberation and proof by involving a writing, a ritual of hot wax, and a physical object that personified its owner. Later, however, the elements of ritual and personification eroded away, so that in most states by statute or decision a seal may now take the form of a printed device, word, or scrawl, the printed initials “L.S.,” or a printed recital of sealing. Few promisors today have even the vaguest idea of the significance of such words, letters, or signs, if they notice them at all. The Restatement Second itself freely admits that “the seal has come to seem archaic.” Considering this drastic change in circumstances, the rule that the seal renders a promise enforceable has ceased to be

tenable under modern conditions. The rule has been changed by statute in about two-thirds of the states, and at least one case held even without the benefit of a statute that the rule should no longer be strictly applied.

Melvin Eisenberg, *The Principles of Consideration*, 67 CORNELL L. REV. 640, 659-60 (1982).

### **2.2.2 The Compromise of Legal Claims as Consideration**

Parties most often end litigation before trial by entering into a settlement agreement. These agreements commonly require some payment by one party in exchange for a release or compromise of legal claims brought by the other party. The Restatement (Second) of Contracts explains how consideration doctrine relates to these promises.

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Please read section 74 of the RESTATEMENT (SECOND) OF CONTRACTS.

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*Questions for discussion of In re Greene:*

What is the strongest argument for the position that there was no consideration for Greene's promise to Leila Trudel? Do you see how Restatement § 74 might support Trudel's contention that this promise should be enforced? How would you expect the court to respond?

Consider whether the interaction between Greene and Trudel satisfies each of the four functions of legal formality that Lon Fuller identified. Can you think of any other factors that might explain the court's evident reluctance to enforce Greene's promises?

Does the fact that the parties memorialized their agreement in a sealed contract affect its enforceability? Should the presence of a seal make a court more likely to enforce? Do you believe that contract law should provide a device that allows parties to make legally enforceable donative promises?

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View the screencast videos on Consideration: [Part One](#) and [Part Two](#).

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## Preparing for Class – Consideration

Consider more carefully Pioneer Theatre's arguments against enforcement of the promise to pay the Bank Night prize. Consider also the relationship between the modern bargain conception of consideration and the more traditional benefit-or-detriment analysis.

Apply conditional gift analysis to *Kirksey v. Kirksey* and try to unravel some of the factual uncertainties surrounding that case. Also, examine more closely Leila Trudel's second asserted ground, in *In re Greene*, for finding consideration (the surrender of all claims).

Although litigated cases only rarely involve genuine challenges to the existence of consideration, the doctrine is a foundation for understanding how courts view their role in enforcing bargains. Bear in mind the bargain theory of consideration when we study promissory estoppel doctrine. You will find that the bargain principle exerts an important influence even outside of the domain of consideration.

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### 3. Adequacy Doctrine

As we saw in *In re Greene*, courts are sometimes skeptical about whether purported consideration embodies a genuine exchange or merely disguises an otherwise unenforceable gift. Parties themselves are sometimes heard to complain that they have not received real or sufficient consideration for their promises. This section explores the doctrinal rules that determine whether this argument succeeds or fails.

### 3.1 *Batsakis v. Demotsis*

The court in *Greene* decided that Leila Trudel had failed to provide legally sufficient consideration to support Greene's promises. Contrast with *Greene* the following case in which the court decides to enforce a promise to pay despite one party's contention that she received inadequate consideration. As you read, try to identify the facts and circumstances that produce these disparate results.

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Please read *Batsakis v. Demotsis* in your volume of Principal Cases.

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#### 3.1.1 The Background of *Batsakis v. Demotsis*

Here is a compelling account of the harrowing conditions residents faced in German-occupied Athens during the early years of World War II:

During the first winter of the occupation, 1941-2, the blockaded cities and the mountain villages, cut off from the plains which had supplied them with grain, salt, and oil, suffered the most. Athens became a nightmare landscape of skeletal figures with bellies swollen, shuffling hopelessly in search of food, falling dead and lying unburied in the streets. The children and the elderly died first.

In the first two months of winter, 300,000 people starved to death in the capital. In order to keep the deceaseds' ration cards, families did not report deaths but threw the corpses surreptitiously over the walls of cemeteries ....

The ration cards were nearly worthless, since bread was nonexistent, the food shops closed and shuttered. The smallest purchases required sacks of paper money.... If a baker happened to find enough flour to bake and sell a loaf of bread, he set the price in British gold sovereigns.

Everyone who could walk spent the entire day until curfew searching for food. The poor stripped the countryside of greens for miles outside

of Athens. Trees in the avenues and parks were cut down for firewood. Servants of the wealthy were sent to outlying villages and islands with family treasures in search of a loaf of bread or a chicken ....

During the winter of 1941 in Athens, packs of stray dogs howled in the hills below the Acropolis, mass graves were dug in the gardens of the royal palace, and death waited on every street corner.

Nickolas Gage, *Eleni* 65-67 (1983).

### **3.1.2 Adequacy Doctrine**

Courts ordinarily honor the rule that the parties are the best judge of the value of the promises they choose to exchange. As long as the parties have satisfied the doctrinal requirement of consideration by making a bargained-for exchange, the Restatement expressly disavows any additional requirement of benefit, detriment, equivalence of values, or “mutuality of obligation.”

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Please read section 79 of the RESTATEMENT (SECOND) OF CONTRACTS.

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Comment c to § 79 elaborates:

To the extent that the apportionment of productive energy and product in the economy are left to private action, the parties to transactions are free to fix their own valuations. The resolution of disputes often requires a determination of value in the more general sense of market value, and such values are commonly fixed as an approximation based on a multitude of private valuations. But in many situations there is no reliable external standard of value, or the general standard is inappropriate to the precise circumstances of the parties. Valuation is left to private action in part because the parties are thought to be better able than others to evaluate the circumstances of particular transactions. In any event, they are not ordinarily bound to follow the valuations of others.

Ordinarily, therefore, courts do not inquire into the adequacy of consideration. This is particularly so when one or both of the values exchanged are uncertain or difficult to measure. But it is also applied even when it is clear that the transaction is a mixture of bargain and gift. ... Gross inadequacy of consideration may be relevant to issues of capacity, fraud, and the like, but the requirement of consideration is not a safeguard against imprudent and improvident contracts except in cases where it appears that there is no bargain in fact.

Comment d to § 79 explains the complementary doctrine of nominal or sham consideration:

Disparity in value, with or without other circumstances, sometimes indicates that the purported consideration was not in fact bargained for but was a mere formality or pretense. Such sham or “nominal” consideration does not satisfy the requirement of § 71.

A prominent contracts scholar reconciles these doctrines in the following excerpt:

Parting with a document, the contents of which can in fact render no service, has been held to be a sufficient consideration for a promise to pay a large sum. Services or property are sufficient consideration for a promise to pay much more money than anyone else would pay for them ....

The rule that market equivalence of consideration is ... to be left solely to the free bargaining process of the parties, leads in extreme cases to seeming absurdities. When the consideration is only a “peppercorn” or a “tomtit” or a worthless piece of paper, the requirement of a consideration appeared to Holmes to be as much of a mere formality as is a seal. In such extreme cases, a tendency may be observed to refuse to apply the rule; but it is a tendency that has not been carried very far. Such cases can sometimes be explained on the ground that the stated consideration was a mere pretense.

1 CORBIN ON CONTRACTS § 127 (1963).



*Questions for discussion of Batsakis v. Demotsis:*

Why do you suppose that the parties chose to draft a contract saying that Demotsis had received \$2,000 when she really received 500,000 drachmae instead?

On what grounds does the court reject Demotsis's contention that the contract should be unenforceable?

Can you think of any policy justifications for the adequacy doctrine expressed in *Batsakis* and in § 79 of the Restatement?

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View the screencast video on [Adequacy Doctrine](#).

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### **Preparing for Class – Adequacy Doctrine**

If consideration requires a bargain, can the parties exchange anything at all, no matter how small or insignificant? Or is there some limit, a threshold requirement that prevents trivial items from being sufficient consideration to support a legally enforceable promise?

Consider carefully how to apply the distinction between genuine bargains and sham consideration and on understanding why courts are reluctant to inquire into the adequacy of consideration.

Adequacy doctrine reveals some important principles that guide courts in their enforcement of contracts. Reflect about the materials we have studied and try to discern how this aspect of consideration doctrine illustrates broader themes, including concerns about judicial capacity, predictability of outcomes, and party autonomy.

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## 4. Promissory Estoppel

Courts have been unwilling to confine contractual liability within the narrow limits of consideration doctrine. Although bargained-for exchanges remain central to contract enforcement, an important line of cases embraces a competing principle of reliance-based enforcement. Even in the absence of an express bargain, a promise may be enforceable if the promisor should reasonably expect it to induce action or forbearance. Thus, promissory estoppel doctrine offers some hope of legal protection to a person who incurs costs or confers benefits in justifiable reliance on a promise.

As many jurists and commentators have observed, however, this reliance principle has the potential to obliterate the distinction between enforceable bargains and unenforceable donative promises that consideration doctrine strives so mightily to maintain.

It would cut up the doctrine of consideration by the roots, if a promisee could make a gratuitous promise binding by subsequently acting on it.

*Commonwealth v. Scituate Savings Bank*, 137 Mass. 301, 302 (1884) (Holmes, J.). The Restatement offers a somewhat amorphous legal standard to describe the circumstances that warrant reliance-based enforcement.

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Please read section 90 of the RESTATEMENT (SECOND) OF CONTRACTS.

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Comment b to § 90 elaborates:

The principle of this Section is flexible. The promisor is affected only by reliance which he does or should foresee, and enforcement must be necessary to avoid injustice. Satisfaction of the latter requirement may depend on the reasonableness of the promisee's reliance, on its definite and substantial character in relation to the remedy sought, on the formality with which the promise is made, on the extent to which the evidentiary, cautionary, deterrent and channeling functions of form are met by the commercial setting or otherwise, and on the extent to which

such other policies as the enforcement of bargains and the prevention of unjust enrichment are relevant.

The language of the Restatement incorporates a large number of factors and explicitly suggests that courts should apply promissory estoppel doctrine flexibly. It remains to be seen whether this flexibility produces a narrow or a broad exception to the bargain theory of consideration. Several prominent commentators have argued that courts still display a reluctance to enforce unbargained-for promises.

[D]etrimental reliance is likely to occur even if no visible evidence of it exists. Between the date of the [gratuitous] promise and that of the repudiation, [the promisee] will have modified his consumption habits in adjustment to his suddenly increased wealth. If this expectation is disappointed, [the promisee's] excessive consumption will have produced a permanent net loss in welfare; this loss is his reliance injury. Courts rarely acknowledge the existence of such uncompensated reliance when they refuse to enforce gratuitous promises. The absence of bargained-for consideration triggers instead a presumption of nonenforcement.

Charles J. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 YALE L.J. 1261, 1302 (1980). After surveying case law to determine how courts were using promissory estoppel doctrine, Professor Stanley Henderson similarly concluded that the success of a § 90 claim depends:

on the ability of the court to reconcile the reliance factor implicit in promissory estoppel with a general theory of consideration which is dominated by notions of reciprocity.... Moreover, the disposition to treat action in reliance as proof of bargain ... seriously impairs the reliance principle in the very cases [of gratuitous promises] in which reliance is likely to be the only available ground for relief.... [Thus] the risk that action in reliance will be found to be not sufficiently serious to justify application of § 90, or merely the condition of a gratuitous promise, is thereby increased.

Stanley Henderson, *Promissory Estoppel and the Traditional Contract Doctrine*, 78 YALE L.J. 343, 345-50 (1969). Another scholar explained why an aggressive promissory estoppel doctrine might impede business negotiations.

Certainly some freedom to change one's mind is necessary for free intercourse between those who lack omniscience. For this reason we cannot accept Dean Pound's theory that all promises in the course of business should be enforced.... [B]usiness men as a whole do not wish the law to enforce every promise. Many business transactions, such as those on a stock or produce exchange, could not be carried on unless we could rely on a mere [oral] agreement or hasty memorandum. But other transactions, like those of real estate, are more complicated and would become too risky if we were bound by every chance promise that escapes us. Negotiations would be checked by such fear. In such cases, men do not want to be bound until the final stage, when some formality like the signing of papers gives one the feeling of security, of having taken the proper precautions.

Felix Cohen, *The Basis of Contract*, 46 HARV. L. REV. 553, 572-74 (1933).

Finally, we might wonder how § 90 came to be part of the Restatement. Professor Grant Gilmore offers the following colorful narrative:

[Consider] the [first] Restatement's definition of consideration [which was then] (§ 75) taken in connection with its most celebrated section, § 90, captioned "Promise Reasonably Inducing Definite and Substantial Action." First § 75:

- (1) Consideration for a promise is
  - (a) an act other than a promise, or
  - (b) a forbearance, or
  - (c) the creation, modification or destruction of a legal relation, or
  - (d) a return promise, bargained for and given in exchange for the promise.

(2) Consideration may be given to the promisor or to some other person. It may be given by the promisee or by some other person.

This is, of course, pure Holmes. The venerable Justice took no part in the Restatement project. It is unlikely that he ever looked at the Restatement of Contracts. If, however, § 75 was ever drawn to his attention, it is not hard to imagine him chuckling at the thought of how his revolutionary teaching of the 1880s had become the orthodoxy of a half-century later. Now § 90:

A promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.

And what is that all about? We have become accustomed to the idea, without in the least understanding it, that the universe includes both matter and anti-matter. Perhaps what we have here is Restatement and anti-Restatement or Contract and anti-Contract. We can be sure that Holmes, who relished a good paradox, would have laughed aloud at the sequence of § 75 and § 90. The one thing that is clear is that these two contradictory propositions cannot live comfortably together: in the end one must swallow the other up.

A good many years ago Professor Corbin gave me his version of how this unlikely combination came about. When the Restaters and their advisors came to the definition of consideration, Williston proposed in substance what became § 75. Corbin submitted a quite different proposal. To understand what the Corbin proposal was about, it is necessary to backtrack somewhat. Even after the Holmesian or bargain theory of consideration had won all but universal acceptance, the New York Court of Appeals had, during the Cardozo period, pursued a line of its own. There is a long series of Cardozo contract opinions, scattered over his long tenure on that court. Taken all in all, they express what might be called an expansive theory of contract. Courts

should make contracts wherever possible, rather than the other way around. Missing terms can be supplied. If an express promise is lacking, an implied promise can easily be found. In particular Cardozo delighted in weaving gossamer spider webs of consideration. There was consideration for a father's promise to pay his engaged daughter an annuity after marriage in the fact that the engaged couple, instead of breaking off the engagement, had in fact married. There was consideration for a pledge to a college endowment campaign (which the donor had later sought to revoke) in the fact that the college, by accepting the pledge, had come under an implied duty to memorialize the donor's name: "The longing for posthumous remembrance is an emotion not so weak as to justify us in saying that its gratification is a negligible good." Evidently a judge who could find "consideration" in *DeCicco v. Schweizer* or in the *Allegheny College* case could, when he was so inclined, find consideration anywhere: the term had been so broadened as to have become meaningless. We may now return to the Restatement debate on the consideration definition. Corbin, who had been deeply influenced by Cardozo, proposed to the Restaters what might be called a Cardozoean definition of consideration—broad, vague and, essentially, meaningless—a common law equivalent of *causa*, or cause. In the debate Corbin and the Cardozoeans lost out to Williston and the Holmesians. In Williston's view, that should have been the end of the matter.

Instead, Corbin returned to the attack. At the next meeting of the Restatement group, he addressed them more or less in the following manner: Gentlemen, you are engaged in restating the common law of contracts. You have recently adopted a definition of consideration. I now submit to you a list of cases—hundreds, perhaps or thousands?—in which courts have imposed contractual liability under circumstances in which, according to your definition, there would be no consideration and therefore no liability. Gentlemen, what do you intend to do about these cases?

To understand Corbin's point we must backtrack and digress again. I have made the point that Holmesian consideration theory had, as

Holmes perfectly well knew, not so much as a leg to stand on if the matter is taken historically. Going back into the past, there was an indefinite number of cases which had imposed liability, in the name of consideration, where nothing like Holmes's "reciprocal conventional inducement" was anywhere in sight. Holmes's point was that these were bad cases and that the range of contractual liability should be confined within narrower limits. By the turn of the century, except in New York, the strict bargain theory of consideration had won general acceptance. But, unlike Holmes, many judges, it appeared, were not prepared to look with stony-eyed indifference on the plight of a plaintiff who had, to his detriment, relied on a defendant's assurances without the protection of a formal contract. However, the new doctrine precluded the judges of the 1900 crop from saying, as their predecessors would have said a half-century earlier, that the "detriment" itself was "consideration." They had to find a new solution, or, at least, a new terminology. In such a situation the word that comes instinctively to the mind of any judge is, of course, "estoppel"—which is simply a way of saying that, for reasons which the court does not care to discuss, there must be judgment for plaintiff. And in the contract cases after 1900 the word "estoppel," modulating into such phrases as "equitable estoppel" and "promissory estoppel," began to appear with increasing frequency. Thus Corbin, in his submission to the Restaters, was plentifully supplied with new, as well as with old, case material.

The Restaters, honorable men, evidently found Corbin's argument unanswerable. However, instead of reopening the debate on the consideration definition, they elected to stand by § 75 but to add a new section—§ 90—incorporating the estoppel idea although without using the word "estoppel." The extent to which the new section § 90 was to be allowed to undercut the underlying principle of § 75 was left entirely unresolved. The format of the Restatement included analytical, discursive, often lengthy comments, interspersed with illustrations—that is, hypothetical cases, the facts of which were frequently drawn from real cases. Section 90 is almost the only section of the Restatement of Contracts which has no Comment at all. Four

hypothetical cases, none of them, so far as I know, based on a real case, are offered as “illustrations,” presumably to indicate the range which the section was meant to have. An attentive study of the four illustrations will lead any analyst to the despairing conclusion, which is of course reinforced by the mysterious text of § 90 itself, that no one had any idea what the damn thing meant.

GRANT GILMORE, *THE DEATH OF CONTRACT* 60-65 (1974).

#### **4.1 *Feinberg v. Pfeiffer Co.***

In this first of two employment cases, the court uses promissory estoppel doctrine to enforce a company’s promise of retirement benefits to a longtime and highly valued employee.

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Please read *Feinberg v. Pfeiffer Co.* in your volume of Principal Cases.

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#### *Questions for discussion:*

Despite the distinguished Justice Hand’s contrary assertion in paragraph 16, promissory estoppel is emphatically not a “recognized species of consideration.” Instead, the Restatement refers to the possibility of enforcing certain promises “without consideration,” and reserves consideration doctrine for situations involving a bargain. *Compare* Restatement (Second) §§ 71 and 90.

Under this understanding of the doctrine, was there consideration for Pfeiffer Company’s promise to Feinberg? What about her many years of loyal and faithful service?

Compare to *Feinberg* the following examples of different types of promises:

(a) “If you agree to continue working for me, I’ll give you a fair share of the profits at the end of the year.”



(b) “If you will voluntarily retire, I will give you a pension of \$200 per month for life.”

Is there consideration in these cases?

Did Feinberg win because the promise was in writing? If not, then why?

#### **4.2 *Hayes v. Plantations Steel Co.***

In this second employment case, the court rejects Hayes’s claim to enforce his former employer’s promise of pension benefits. As you read the court’s opinion, consider how Hayes’s circumstances differ from Feinberg’s.

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Please read *Hayes v. Plantations Steel Co.* in your volume of Principal Cases.

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#### *Questions for discussion:*

Was there consideration for Plantations Steel’s promise to Hayes?

How does the court respond to Hayes’s effort to invoke promissory estoppel doctrine?

What facts distinguish Hayes’s situation from Feinberg’s?

Thinking more broadly about the enforcement decision in these cases, what circumstances appear to influence courts and make enforcement more or less likely?

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View the screencast video on [Promissory Estoppel](#).

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### **Preparing for Class – Promissory Estoppel**

Should courts insist on finding evidence of a bargain in order to enforce a promise? Or could contractual liability embrace other grounds for enforcement? This

section introduces the principal alternative to the bargain theory of consideration. And it also shows just how uncertain and limited promissory estoppel doctrine really is.

Consider the rather amorphous doctrinal test for promissory estoppel liability. Try to develop theories to explain the different results in *Hayes* and *Feinberg*.

It would be valuable to reflect on the features of promissory estoppel doctrine that make it so malleable and ill-defined. You should also bear our analysis of this doctrine in mind when we later discuss the institution of formal closings and the problem of liability for promises made during contract negotiations.

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## 5. The Material Benefit Rule

Another alternative basis for enforcement of promises in the absence of consideration is the so-called material benefit rule. In a mere handful of cases, courts have chosen to enforce promises made in recognition of prior benefits received. The Restatement (Second) expresses this doctrinal principle in terms arguably even more opaque than those of Section 90 concerning promissory estoppel.

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Please read section 86 of the RESTATEMENT (SECOND) OF CONTRACTS.

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Both before and after the adoption of this Restatement section in 1981, courts have used the material benefit rule sparingly. In *Webb v. McGowin*, 168 So. 196 (Ala. App. 1935), for example, a mill worker throwing chunks of wood from the second floor of a mill held onto one heavy block as it fell in order to prevent it from landing on his boss. The worker sustained serious injuries and the mill owner promised to give him a small pension for life. When the owner died eight years later, his estate refused to continue the payments, and the court held that this promise for prior benefits should be enforced. However, courts quite frequently decline to invoke the doctrine to enforce promises recognizing past benefits.

In the following excerpt, Professor Grant Gilmore offers a characteristically witty account of the halting development of the case law.

The hesitant and cautious text of the new section no doubt reflects the uncertainties of the Reporter and his advisers. . . . [W]hat Subsection (1) giveth, Subsection (2) largely taketh away: the promise . . . will be “binding” only within narrow limits. Furthermore, the use which is made in the Commentary of two of our best known Good Samaritan cases contributes a perhaps desirable confusion:

A gives emergency care to B’s adult son while the son is sick and without funds far from home. B subsequently promises to reimburse A for his expenses. The promise is not binding under this section. [Illustration 1, based on *Mills v. Wyman*, 20 Mass. 207 (1825).]

A saves B’s life in an emergency and is totally and permanently disabled in so doing. One month later B promises to pay A \$15 every two weeks for the rest of A’s life, and B makes the payments for eight years until he dies. The promise is binding. [Illustration 7, based on *Webb v. McGowin*].

The idea that § [86] has succeeded in “codifying” both the nineteenth century Massachusetts case and the twentieth century Alabama case is already sufficiently surprising but we are not yet finished.

A finds B’s escaped bull and feeds and cares for it. B’s subsequent promise to pay reasonable compensation to A is binding. [Illustration 6, based on *Boothe v. Fitzpatrick*, 36 Vt. 681 (1864).]

Are we to believe that my promise to pay the stranger who takes care of my bull is binding but that my promise to pay the stranger who takes care of my dying son is not? Or that “adult sons” are supposed to be able to take care of themselves while “escaped bulls” are not? Or that, as in maritime salvage law, saving property is to be rewarded but saving life is not?

Enough has been said to make the point that Restatement (Second), at least in § [86], is characterized by the same “schizophrenic quality” for which Restatement (First) was so notable. This may well be all to the good. A wise draftsman, when he is dealing with novel issues in course of uncertain development, will deliberately retreat into ambiguity. The principal thing is that Restatement (Second) gives overt recognition to an important principle whose existence Restatement (First) ignored and, by implication denied. By the time we get to Restatement (Third) it may well be that § [86] will have flowered like Jack’s bean-stalk. . . .

GRANT GILMORE, *THE DEATH OF CONTRACT* 74-76 (1974).

### III. CONTRACT FORMATION

We turn our attention now to a closer study of the process by which parties form a contract. In the sections that follow, we will learn how to identify an offer and what constitutes an acceptance. We will examine the special rules for offers of a unilateral contract and for firm offers. Finally, we will tackle the intricacies of UCC § 2-207 and debate the legal policies applicable to modern consumer contracting.

All of these rules derive from the fundamental principle that contractual obligations are based on consent. For centuries, courts applied a subjective test to determine whether each of the parties truly intended to form a binding contract. They spoke of “a meeting of the minds” between the parties. As we have already seen in discussing *Lucy v. Zehmer*, however, more modern decisions focus instead on the parties’ outward manifestations to determine their contractual intent. And older cases used various legal fictions and other devices to protect promisees who reasonably believed that a promisor had made a binding commitment. Thus, Restatement (Second) of Contracts § 17 requires only “a manifestation of mutual assent” to an exchange. This so-called “objective theory” of contract finds expression in the Restatement and in the cases that follow.

#### 1. Offer

Parties ordinarily manifest their mutual assent to a contract by means of an offer and acceptance. The Restatement (Second) of Contracts describes a flexible approach to finding mutual assent. And the Uniform Commercial Code adopts an even more liberal approach to demonstrating consent.

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Please read section 22 of the RESTATEMENT (SECOND) OF CONTRACTS and UCC § 2-204, and always read accompanying comments.

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Although more complicated situations sometimes arise, it is often helpful to begin to analyze parties’ negotiations by trying to identify an offer made and an

acceptance given. One prominent commentator explained the essential elements of contract formation as follows:

An offer is an act on the part of one person whereby he gives to another the legal power of creating the obligation called contract. An acceptance is the exercise of the power conferred by the performance of some act or acts. Both offer and acceptance must be acts expressing assent.

The act constituting an offer and the act of constituting an acceptance may each consist of a promise. A promise is an expression of intention that the promisor will conduct himself in a specified way in the future, with an invitation to the promisee to rely thereon. If only one of the acts has this character, the contract is unilateral. If both acts have this character, the contract is bilateral.

Arthur Corbin, *Offer and Acceptance, and Some of the Resulting Legal Relations*, 26 YALE L.J. 169, 171 (1917).

The Restatement (Second) of Contracts includes several provisions defining the nature of an offer.

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Please read sections 24 and 26 of the RESTATEMENT (SECOND) OF CONTRACTS.

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### **1.0.1 Hypo on Offer Rules**

A listing on [www.craigslist.org](http://www.craigslist.org) advertised the following vehicle for sale:

2014 GMC Suburban 4WD. Rare 9-seat model. Under warranty!  
Original MSRP \$43,000, current blue book \$13-14,000, will sacrifice for \$10K. Call Kendall at (913) 240-6349 or (434) 985-2101.

Suppose that on the morning that this listing first appears, George buys the gas-guzzling monster from Kendall. Later the same day, Travis calls Kendall. When

Kendall answers the phone “Hello,” Travis says, “I accept your offer to sell the Suburban for \$10,000.”

Apply the legal rules defining offer to this interaction. Did Kendall make an offer to contract when they listed their truck on craigslist.org? How do you suppose that people would respond if courts held that advertisements of this sort are binding offers?

### **1.1 *Dyno Construction Co. v. McWane, Inc.***

This case gives you a more complicated factual situation in which to test your understanding of the rules governing offers. As you read, try to identify precisely what language in the purported offer and what surrounding circumstances most affected the court’s decision.

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Please read *Dyno Construction Co. v. McWane* in your volume of Principal Cases.

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#### *Questions for discussion:*

One way of applying the offer rules is to examine “text” and “context.” The language of the purported offer and the surrounding factual circumstances usually determine whether a court construes a particular manifestation as an offer.

In *Dyno Construction*, how does an analysis of the text or language of the company’s purported offer influence the court’s determination that the contract was not formed until December 1, 1995?

Is there any evidence about the factual context of these negotiations that tends to reinforce this conclusion?

#### **1.1.1 Hypo on Seed Sale**

On September 21, 2000, Amity Seed & Grain Warehouse mailed out samples of clover seed to a large number of dealers in an envelope printed with the following message:

Red clover. 50,000 lbs. like sample. I am asking 24 cents per, f.o.b. Amity, Oregon. Amity Seed & Grain Warehouse.

On October 8, Courteen Seed Co. wired a reply:

Special delivery sample received. Your price too high. Wire firm offer, naming absolutely lowest f.o.b.

The same day, Amity Seed answered this request by telegram:

I am asking 23 cents per pound for the car of red clover seed from which your sample was taken. No. 1 seed, practically no plantain whatever. Have an offer 22 3/4 per pound, f.o.b. Amity.

Courteen responded the next day:

Telegram received. We accept your offer. Ship promptly, route care of Milwaukee Road at Omaha.

Amity Seed has now refused to deliver.

How would you apply the offer rules to this situation?

## **1.2 *Lefkowitz v. Great Minneapolis Surplus Store***

The following case illustrates an exception that proves the general rule that advertisements are not enforceable as offers. As you read, attend carefully to the court's reasoning about the two separate ads. Does the opinion's analysis comport with your understanding of the principles underlying offer doctrine?

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Please read *Lefkowitz v. Great Minneapolis Surplus Store* in your volume of Principal Cases.

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### 1.2.1 Punitive Enforcement

Professors Ian Ayres and Robert Gertner have argued that the *Lefkowitz* court should have enforced the first advertisement as well as the second one:

Ask yourself the simple question: What kind of ad is the Great Minneapolis Surplus Store going to run the week following the court's decision? By lending its imprimatur to the indefinite ad, the court allows retailers to induce inefficient consumer reliance with impunity. The *Lefkowitz* case dramatically illustrates that only by enforcing indefinite offers against the offeror can one drive out indefinite offers.

*Lefkowitz* was wrongly decided. The defendant's offer was intentionally vague to induce inefficient reliance on the part of the buyer (Lefkowitz incurred the "shoe leather" costs of traveling to the store). Courts can retain the common law's general reluctance to enforce indefinite contracts so that both parties will have an incentive to make the contracts more definite. But *Lefkowitz* illustrates an exception to this general rule. When the indefiniteness is clearly attributable to one party and induces inefficient reliance from the other party, punitive enforcement may be efficient to drive out inefficient offers.

Ian Ayres and Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 107 (1989).

*Questions for discussion of Lefkowitz:*

See if you can develop an argument that the *Lefkowitz* court was wrong about both the first and the second advertisements.

In your own experience as a consumer have you seen any evidence that advertisers are worried about making offers?

### 1.2.2 Hypo on Killer Collecting Reward

Los Angeles authorities announced a \$500,000 reward for information leading to the arrest and conviction of a serial killer believed to be responsible for eleven murders. "[Police] have linked these cases as having common threads of evidence - ballistics, DNA and a variety of other forensics," said Los Angeles city council member Bernard Parks, who sponsored the reward.

Suppose that the killer decides to turn himself in and claim the reward. If city authorities refuse to pay, how would you expect a court to rule on the killer's claim?

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View the screencast video on [Offer](#).

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### Preparing for Class – Offer

Now that we have a better understanding of what sort of promises courts are willing to enforce, it's time to turn our attention to the process by which parties form a binding contract. Although negotiations can sometimes blur these distinctions, courts usually look for an offer from one party that the other party has accepted. The goal of this and the next several sections is to establish the basic structure of contract formation and then to explore doctrinal nuances and challenges to the conventional pattern.

Consider what factors best predict when courts will construe a communication as an offer. Offer and acceptance are fundamental to contractual liability and to everyday transactional practice. As we explore more complex problems of contract formation, you should consider carefully how these basic doctrinal principles can be adapted to each new situation.

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## 2. Acceptance

To accept an offer is to exercise the power that an offer creates. The Restatement (Second) of Contracts includes sections defining acceptance and discussing the offeror's control over the manner of acceptance:

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Please read sections 30 and 50 of the RESTATEMENT (SECOND) OF CONTRACTS.

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Professor Corbin elaborates on these doctrinal principles in the following terms:

An acceptance is a voluntary act of the offeree whereby he exercises the power conferred on him by the offer, and thereby creates the set of legal relations called a contract. What acts are sufficient to secure this purpose? We must look first to the terms in which the offer was expressed, either by words or by other conduct. The offeror is the creator of the power and at the time of its creation he has full control over both the fact of its existence and its terms. The offeror has, in the beginning, full power to determine the acts that are to constitute acceptance. After he has once created the power, he may lose his control over it, and may become disabled to change or revoke it; but the fact that, in the beginning, the offeror has full control . . . is the characteristic that distinguishes contractual relations from noncontractual ones. After the offeror has created the power [of acceptance], the legal consequences are out of his hands, and he may be brought into numerous consequential relations of which he did not dream, and to which he might not have consented. These later relations are nevertheless called contractual.

Arthur Corbin, *Offer and Acceptance, and Some of the Resulting Legal Relations*, 26 YALE L.J. 169, 199-200 (1917),

## **2.1 *Ever-Tite Roofing Corp. v. Green***

Our next principal case involves an unusual situation in which the promisee accepts an offer by beginning to perform. As you read, attend carefully to the precise terms of the initial offer. You will also want to note how the court’s analysis depends on an assessment of which party had the comparative advantage in taking precautions to avoid misunderstanding.

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Please read *Ever-Tite Roofing Corp. v. Green* in your volume of Principal Cases.

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### **2.1.1 Selecting the Permissible Mode of Acceptance**

Both the Restatement (Second) of Contracts and the Uniform Commercial Code include rules to govern the permissible mode of acceptance. The Restatement allows an offeree to use any reasonable method unless the offeror has specified that a particular method is required. The UCC specifies similarly permissive rules for situations in which the offer leaves open the means of acceptance but makes the offeror “master of the offer” when she chooses to specify how it should be accepted.

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Please read sections 32 and 60 of the RESTATEMENT (SECOND) OF CONTRACTS and UCC § 2-206.

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### **2.1.2 Note on *Antonucci v. Stevens Dodge***

Leonard Antonucci ordered a new “Club Cab” pickup truck from Stevens Dodge. The salesman filled out a preprinted order form and Antonucci paid a \$500 deposit. The court described the order:

In the bottom lefthand corner of the agreement there is printed in large underlined type: “. . . THIS ORDER SHALL NOT BECOME BINDING UNTIL ACCEPTED BY DEALER OR HIS

AUTHORIZED REPRESENTATIVE.” At the bottom of the paragraph containing this sentence is a blank line under which is printed “purchaser's signature.” Plaintiff signed on this line. Below this is a blank line which has printed before it “Accepted By.” Under this line is printed “Dealer or his Authorized Representative.” This line bears no signature.

On the back of the agreement are printed ten conditions. The heading on top of this page states: “It is further understood and agreed: The order on the reverse side hereof is subject to the following terms and conditions which have been mutually agreed upon.” Paragraph 10 states: “This order is subject to acceptance by the dealer, which acceptance shall be signified by the signature of Dealer, Dealer's Manager or other authorized signature on the reverse side hereof.”

*Antonucci v. Stevens Dodge, Inc.*, 73 Misc. 2d 173, 340 N.Y.S. 2d 979 (1973).

When the truck arrived, a controversy arose about whether the model delivered was the “Club Cab” that Antonucci had ordered. What result would you expect when Antonucci sues Stevens Dodge to recover his deposit?

*Questions for discussion of Ever-Tite Roofing:*

What would have happened in *Ever-Tite* if the form contract read like the agreement in *Antonucci v. Stevens Dodge* (e.g., “This agreement shall not become binding until signed by contractor or his authorized representative.”)?

Suppose as well that the Greens let Ever-Tite begin work on their roof. Could they later repudiate on the ground that the contractor didn't sign the contract?

Now suppose that the contract said: “This agreement is not binding until accepted. Acceptance should be executed on the acknowledgement copy and returned to the client/owner.” How would you expect a court to resolve this variation on the facts of *Ever-Tite*?

Does the Restatement have anything to say about this situation?

As a general principle, who has the power to determine the manner in which an offer will be accepted?

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View the screencast video on [Acceptance](#).

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## Preparing for Class – Acceptance

As we have seen, an offer creates the power to form a contract by accepting. To accept is thus to exercise the power that an offer creates. When the offeror specifies a particular method of acceptance, the offeree must use that method to form a binding contract. We have read several cases that illustrate the application of this rule. But what happens if the offeror omits any mention of how to accept or makes only a suggestion about the method of acceptance? In this case, the offeree may choose any method that is reasonable in the circumstances.

The rules on offer and acceptance frequently affect what attorneys and parties do in practice. In addition to the obvious importance of knowing when your client is or is not making an offer and how your client should go about accepting someone else's offer, parties often want to exercise more control over when a contract will be formed. Concerns about being bound too early have produced the important institution of the formal closing, which we will discuss in the next section.

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### 2.2 *Ciaramella v. Reader's Digest Association*

Our next principal case offers some insight into the rules that apply to forming an agreement to settle claims in litigation. Negotiations over settlement agreements usually involve principals—the parties themselves—and agents—their attorneys. The court in *Ciaramella* explains under what circumstances the agents can or cannot bind their principals.

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Please read *Ciaramella v. Reader's Digest Assoc.* in your volume of Principal Cases.

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### 2.2.1 Preliminary Agreements

A frequently recurring fact pattern arises when parties orally express agreement on a deal (or draft a preliminary “agreement in principle”) but they also agree to memorialize their agreement in a more formal writing. When, as in *Ciaramella*, one of the parties refuses to sign the final written contract, courts sometimes struggle to determine whether the parties intended to be bound by their earlier oral (or incomplete written) agreement. The Restatement (Second) of Contracts largely punts on this question:

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Please read sections 26 and 27 of the RESTATEMENT (SECOND) OF CONTRACTS.

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A prominent federal judge from New York has proposed a more complex approach—the so-called “Leval Test”—that is explained in this Second Circuit opinion:

Parties to proposed . . . transactions often enter into preliminary agreements, which may provide for the execution of more formal agreements. When they do so and the parties fail to execute a more formal agreement, the issue arises as to whether the preliminary agreement is a binding contract or an unenforceable agreement to agree. Ordinarily, where the parties contemplate further negotiations and the execution of a formal instrument, a preliminary agreement does not create a binding contract. In some circumstances, however, preliminary agreements can create binding obligations. Usually, binding preliminary agreements fall into one of two categories.

The first is a fully binding preliminary agreement, which is created when the parties agree on all the points that require negotiation but agree to memorialize their agreement in a more formal document.

Such an agreement is fully binding; it is “preliminary only in form — only in the sense that the parties desire a more elaborate formalization of the agreement.” A binding preliminary agreement binds both sides to their ultimate contractual objective in recognition that, “despite the anticipation of further formalities,” a contract has been reached. Accordingly, a party may demand performance of the transaction even though the parties fail to produce the “more elaborate formalization of the agreement.”

The second type of preliminary agreement, dubbed a “binding preliminary commitment” by Judge Leval, is binding only to a certain degree. It is created when the parties agree on certain major terms, but leave other terms open for further negotiation. The parties “accept a mutual commitment to negotiate together in good faith in an effort to reach final agreement.” In contrast to a fully binding preliminary agreement, a “binding preliminary commitment” “does not commit the parties to their ultimate contractual objective but rather to the obligation to negotiate the open issues in good faith in an attempt to reach the . . . objective within the agreed framework.” A party to such a binding preliminary commitment has no right to demand performance of the transaction. Indeed, if a final contract is not agreed upon, the parties may abandon the transaction as long as they have made a good faith effort to close the deal and have not insisted on conditions that do not conform to the preliminary writing.

Hence, if a preliminary agreement is of the first type, the parties are fully bound to carry out the terms of the agreement even if the formal instrument is never executed. If a preliminary agreement is of the second type, the parties are bound only to make a good faith effort to negotiate and agree upon the open terms and a final agreement; if they fail to reach such a final agreement after making a good faith effort to do so, there is no further obligation. Finally, however, if the preliminary writing was not intended to be binding on the parties at all, the writing is a mere proposal, and neither party has an obligation to negotiate further.



Courts confronted with the issue of determining whether a preliminary agreement is binding, as an agreement of either the first or the second type, must keep two competing interests in mind. First, courts must be wary of “trapping parties in surprise contractual obligations that they never intended” to undertake. Second, “courts [must] enforce and preserve agreements that were intended [to be] binding, despite a need for further documentation or further negotiation,” for it is “the aim of contract law to gratify, not to defeat, expectations.” The key, of course, is the intent of the parties: whether the parties intended to be bound, and if so, to what extent. “To discern that intent a court must look to ‘the words and deeds [of the parties] which constitute objective signs in a given set of circumstances.’ ” Subjective evidence of intent, on the other hand, is generally not considered.

*Adjustrite Systems, Inc. v. Gab Business Services, Inc.*, 145 F.3d 543, 549 (2d Cir. 1998).

In view of the uncertainty attending the judicial resolution of these questions, parties to commercial negotiations quite often draft explicit clauses to govern the legal effect of their preliminary agreements. One example of such a clause follows:

This Heads of Agreement (“HOA”) is intended solely as a basis for further discussion and is not intended to be and does not constitute a binding obligation of the parties. No legally binding obligations on the parties will be created, implied, or inferred until appropriate documents in final form are executed and delivered by each of the parties regarding the subject matter of this HOA and containing all other essential terms of an agreed upon transaction. Without limiting the generality of the foregoing, it is the parties’ intent that, until that event, no agreement binding on the parties shall exist and there shall be no obligations whatsoever based on such things as parol evidence, extended negotiations, “handshakes,” oral understandings, or course of conduct (including reliance and changes of position).

*Questions for discussion of Ciaramella:*

What facts in *Ciaramella* allow the court to hold that “We have a deal” doesn’t mean that the parties have a legally binding deal?

Suppose that the principals of two businesses meet and hash out the basic elements of a merger agreement. They shake hands and say, “It’s a deal.” Then they send their lawyers back to draft a formal contract. What result if one of the parties decides to back out of the deal before signing the formal written agreement? Is this a binding contract?

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View the screencast video on [Formal Closings](#).

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### **Preparing for Class – Formal Closings**

As we saw in the section on acceptance, parties to major commercial contracts (and those negotiating settlement agreements) often choose to contract around the default rules for offer and acceptance. They may include in their draft agreements language indicating that only the final written agreement will be binding. Or they may negotiate a clause like the one reprinted in the textbook that expressly disclaims any liability arising from written or oral preliminary agreements. After you've studied these materials, you should be able to explain why this practice is so common and how requiring a formal closing creates some risks for parties during the time between an agreement in principle and the closing.

See if you can identify each of the distinct arguments the court uses to reject Reader's Digest's claim that Eisenberg's statement "We have a deal" formed a binding settlement agreement. Focus on a close reading of the arguments in *Ciaramella*.

One good way to develop your ability to make and analyze legal arguments is to practice untangling the arguments contained in judicial opinions or briefs or in any other legal writing. You should compare your list of arguments from *Ciaramella* to those raised in class discussion. Think carefully about how you identified each issue and what led you to overlook some, if any.

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### 2.2.2 The Mailbox Rule

Contractual offers and acceptances are sometimes transmitted through the mail. Problems can arise during the period that an offer or acceptance is in transit between the parties. Courts have developed rules to resolve these problems. The most famous is the so-called “mailbox rule” described in the Restatement (Second) of Contracts.

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Please read sections 63 and 66 of the RESTATEMENT (SECOND) OF CONTRACTS.

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The U.S. Postal Service regulation to which the Restatement’s first comment refers was issued years before the adoption of § 63 and provided:

(c) On receipt of a request for the return of any article of mail matter the postmaster or railway postal clerk to whom such request is addressed shall return such matter in a penalty envelope, to the mailing postmaster, who shall deliver it to the sender upon payment of all expenses and the regular rate of postage on the matter returned....

39 C.F.R. ¶ 10.09, 10.10 (1939 ed.). Despite periodic calls to reform the mailbox rule, courts generally have adhered to this traditional approach to determining the time of acceptance.

Although we will take up revocation in the next section, it is convenient to note here that when parties bargain by mail a corollary of the mailbox rule governs the timing of revocation.

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Please read section 42 of the RESTATEMENT (SECOND) OF CONTRACTS.

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View the screencast video on the [Mailbox Rule](#).

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### **Preparing for Class – The Mailbox Rule**

Although it rarely matters in modern litigation or counseling practice, it's worth knowing the basics of the so-called mailbox rule. You should think of this doctrine as an essentially arbitrary rule that serves a useful purpose because it is usually easy to apply and parties have no trouble bargaining around it when they need to prevent the speculation and strategic behavior that mailing offers and acceptances can permit.

The next time you see the mailbox rule is likely to be when you're studying for a state bar exam.

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### **3. Revocation of Offers**

As we have seen, an offer gives an offeree the power to form a contract by accepting. The Restatement (Second) of Contracts describes a number of ways that the offeree's power to accept may end.

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Please read section 36 of the RESTATEMENT (SECOND) OF CONTRACTS.

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We will discuss both the common law and UCC rules governing rejection and counteroffers in the next section. For the moment, note that an offer ordinarily remains open long enough to give the offeree a reasonable opportunity to accept. An oral offer made during a face-to-face or telephone conversation expires at the end of that conversation unless the offeror has indicated a willingness to keep the offer open beyond that time. The offeror nevertheless retains the right to terminate her offer at

any subsequent time unless she has also expressly agreed not to revoke it—thus creating a “firm offer.”

Recall that in order to accept an offer of a unilateral contract an offeree must tender a performance rather than a reciprocal promise. The consequences of a revocation are especially acute when an offeror revokes such an offer after the offeree has begun performing. In the following excerpt, a scholar defends the early common law rule, which required full performance for acceptance:

Suppose A says to B, “I will give you \$100 if you walk across the Brooklyn Bridge,” and B walks — is there a contract? It is clear that A is not asking B for B’s promise to walk across the Brooklyn Bridge. What A wants from B is the act of walking across the bridge. When B has walked across the bridge there is a contract, and A is then bound to pay to B \$100. At that moment there arises a unilateral contract. A has bartered away his volition for B’s act of walking across the Brooklyn Bridge.

When an act is thus wanted in return for a promise, a unilateral contract is created when the act is done. It is clear that only one party is bound. B is not bound to walk across the Brooklyn Bridge, but A is bound to pay B \$100 if B does so. Thus, in unilateral contracts, on one side we find merely an act, on the other side a promise.

It is plain that in the Brooklyn Bridge case as first put, what A wants from B is the act of walking across the Brooklyn Bridge. A does not ask for B’s promise to walk across the bridge and B has never given it. B has never bound himself to walk across the bridge. A, however, has bound himself to pay \$100 to B, if B does so. Let us suppose that B starts to walk across the Brooklyn Bridge and has gone about one-half of the way across. At that moment A overtakes B and says to him, “I withdraw my offer.” Has B then any rights against A? Again, let us suppose that after A has said, “I withdraw my offer,” B continues to walk across the Brooklyn Bridge and completes the act of crossing.

Under these circumstances, has B any rights against A? In the first of the cases just suggested, A withdrew his offer before B had walked

across the bridge. What A wanted from B, what A asked for, was the act of walking across the bridge. Until that was done, B had not given to A what A had requested. The acceptance by B of A's offer could be nothing but the act on B's part of crossing the bridge. It is elementary that an offeror may withdraw his offer until it has been accepted. It follows logically that A is perfectly within his rights in withdrawing his offer before B has accepted it by walking across the bridge — the act contemplated by the offeror and the offeree as the acceptance of the offer.

Maurice Wormser, *The True Conception of Unilateral Contracts*, 26 YALE L.J. 136-38 (1916).

More recent decisions have rejected this traditional approach. Courts now protect the offeree who has begun performance by barring revocation of the offer until the offeree has had a reasonable opportunity to complete the requested performance. The Restatement (Second) of Contracts sensibly describes the resulting obligation as an option contract.

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Please read section 45 of the RESTATEMENT (SECOND) OF CONTRACTS.

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### **3.1 Irrevocable Offers**

The rule for unilateral contracts described in Restatement § 45 creates an implied option contract once an offeree has begun performing and gives her a reasonable time to complete performance. In other circumstances, however, parties may prefer to create an express option contract.

Imagine, for example, that Amy is considering whether to expand her grape vineyard by buying additional acreage from Julian. Her decision about the purchase depends on the results of extensive soil tests and a detailed marketing study. Amy is unwilling to incur these costs unless she has some assurance that Julian will not sell the property to someone else. Recognizing Amy's predicament, suppose that Julian

offers to sell the acreage to her for \$450,000 and further agrees to keep this offer open for one month while she completes her investigations.

We will see shortly that Julian's offer may be binding as an option contract under Restatement § 87 if it satisfies certain formal requirements or, in some cases, simply as a result of Amy's reliance on the offer. However, Amy may worry that enforcement under these provisions is too uncertain. In order to form an express option contract, Amy needs to pay Julian for the option. If she pays \$200 in exchange for Julian's promise to keep the offer open, the parties will have formed a binding option contract. The Restatement (Second) of Contracts endorses this approach.

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Please read section 25 of the RESTATEMENT (SECOND) OF CONTRACTS.

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It is frequently not feasible, however, to pay for an option contract. Under the Uniform Commercial Code, a merchant may also make a "firm offer" that will be binding as an option contract. The statutory provisions governing firm offers combine both formal and substantive requirements. The Restatement (Second) of Contracts provides a somewhat similar doctrinal mechanism for making firm offers.

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Please read section 87 of the RESTATEMENT (SECOND) OF CONTRACTS  
and UCC § 2-205.

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*Questions for discussion of revocation and firm offers:*

As compared to an express option contract, both UCC § 2-205 and Restatement § 87 involve far more subtle legal issues. Our next principal case, *Pavel Enterprises v. A.S. Johnson Co.*, illustrates the application of the common law rules to construction bidding. But first consider a couple of simpler factual settings.

Suppose, for example, that I offer my son Eric \$500 to juggle three tennis balls 5,000 times in succession. When Eric gets to 4,950, I yell "I revoke." What would Wormser say about my attempted revocation?

What if anything is wrong with Wormser’s reasoning? Does Wormser accurately describe the agreement that the parties would have reached if they had considered this issue carefully at the outset of their relationship—the “hypothetical bargain” that they would have made? How would you apply this hypothetical bargain analysis to our juggling hypothetical?

Consider a more complicated contractual setting. What if Glen offers Rachel \$500 to paint his garage? Rachel begins the prep work for this painting project (e.g., scraping, sanding and caulking) and then disappears for a month or two. Is Glen still obliged to let Rachel finish the painting work?

### **3.2 *Pavel Enterprises, Inc. v. A.S. Johnson Co.***

Our next principal case involves a complex legal analysis of an equally complex commercial relationship. As you read, try to untangle both the different strands of the court’s doctrinal approach and the practical aspects of the subcontract bidding process that gave rise to the conflict between the parties.

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Please read *Pavel Enterprises v. A.S. Johnson Co.* in your volume of Principal Cases.

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#### *Questions for discussion:*

In *Pavel Enterprises*, the court refers to two seminal cases (*Baird* and *Drennan*) that take diametrically opposed views of the rules governing the enforcement of construction bids. Under the comparatively restrictive approach of *Baird*, how could the general contractor have secured an irrevocable offer for the linoleum?

How does *Drennan* allow parties to accomplish the same objective without requiring any additional steps?

Can you apply a hypothetical bargain analysis to the problems that commonly arise in construction bidding? Does that analysis justify constraining subcontractors who wish to disavow their bids? What limitations, if any, should we impose on the rights that these rules confer on general contractors?



### 3.3 The Mirror Image Rule

Recall from our discussion of Restatement § 36 that an offeree loses the power of acceptance when they reject an offer or make a counteroffer. The following case involves an application of this rule.

### 3.4 *Dataserv Equipment, Inc. v. Technology Finance Leasing*

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Please read *Dataserv Equipment, Inc. v. Technology Finance Leasing* in your volume of Principal Cases.

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#### 3.4.1 The Mirror Image Rule and the Last Shot Doctrine

Parties often negotiate by exchanging written or oral proposals that they hope will culminate in a binding contractual agreement. In many negotiations, these proposals take the form of offers and counteroffers. As we have seen, an offer gives an offeree the power to form a contract by assenting to the proposed bargain. Thus, when Leslie offers to sell Josh her 2006 Acura TL for \$25,000, Josh can either accept her offer and form a binding contract or reject it and continue negotiating for a better deal. In these situations, the legal consequences of Josh's response are clear.

But what happens if the offeree's response cannot be so easily classified? Suppose that Josh replies with enthusiastic assent to the bargain but, at the same time, indicates that he expects the deal to include the stylish fleece seat covers and portable GPS unit with which Leslie has equipped her car. As we will shortly learn, the Uniform Commercial Code provision that applies to this sale (recall that a car is unquestionably a "good" within the meaning of the UCC) departs significantly from the traditional common law approach to this situation. Nevertheless, it is instructive to consider how the common law rules would treat this interaction.

Under the so-called "mirror image rule," an acceptance must manifest assent to all and only the precise terms of the offer. A purported acceptance like Josh's that proposes different or additional terms would be treated as a counteroffer. The offeree may not add conditions or limitations to his acceptance, and any attempt to vary the

terms of the original offer is equivalent to a rejection of that offer. Thus, Josh's response would terminate his power of acceptance and give rise to a new offer that Leslie may accept or reject as she wishes. Only if the parties agreed to keep the original offer open, for example, by creating an option contract, would Josh retain the ability to form a contract by accepting Leslie's original offer.

Suppose now that Airport Motors and Wheels for Less are negotiating a similar deal by mail. Airport Motors sends Wheels for Less a letter containing the initial offer described above along with terms specifying that the vehicle is being sold "as is" with no warranty of any kind. In reply, Wheels for Less writes to accept and requests delivery within one week, but the acceptance letter also includes the company's standard "Terms of Sale" providing for a 90-day warranty against any defects in the engine or transmission. Airport Motors responds the next day with a "Confirmation of Sale" form that describes the vehicle and reiterates the company's disclaimer of any warranties. Several days later, Airport Motors delivers the Acura and Wheels for Less accepts the delivery. During a test drive the next week, the engine's head gasket cracks. Wheels for Less seeks to enforce the terms of the warranty contained in the company's acceptance.

The mirror image rule implies that both the second and third communications were counteroffers that rejected the preceding offers. So do the parties have a contract, and if so, what are its terms? Under the so-called "last shot doctrine," a court applying traditional common law principles would hold that by accepting delivery of the car and remaining silent in the face of the "Confirmation of Sale," Wheels for Less accepted the terms of Airport Motors' final counteroffer. The idea is that the "Confirmation of Sale" was the "last shot fired" between the parties during their negotiations. Now that their conduct demonstrates the existence of a contract, the common law uses a rather formal and mechanical rule to determine whose terms prevail. In our case, there is no enforceable warranty and this buyer would be out of luck.

Bear in mind, however, that the Uniform Commercial Code governs this transaction involving the sale of goods. As we will see in the next section, UCC § 2-207 produces exactly the opposite result on the facts we have been considering.

*Questions for discussion of Dataserv Equipment:*

What is it about Dataserv's response to Technology's offer that causes the court to rule that there is no contract?

Suppose for a moment that the parties in *Dataserv Equipment* had gone on to perform. Can you see how the "last shot doctrine" has the potential to produce formalistic and arbitrary results?

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View the screencast videos on Revocation and Firm Offers: [Part One](#) and [Part Two](#).

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### **3.4.2. The Problem of the General Contractor**

This problem reflects the style of a typical law school exam question. It will give you an opportunity to practice writing a short essay response and also to apply the doctrinal rules and broader principles.

Do not begin reading this problem until you are ready to write your response to the question. You should take no more than 45 minutes to read the question and prepare your answer.

Knott Builders, Inc. is a general contractor producing custom homes for discriminating clients in Albemarle County. Anderson Supply Co. is a local wholesale distributor of granite countertops. Banks Services Co. is a mechanical subcontractor that does plumbing and electrical work. Carl Carter is an installer of custom kitchen cabinets and countertops. Knott was recently preparing to bid on a new project. The company asked Anderson, Banks, and Carter to quote a price for some of the extensive materials and services needed to complete the job.

Anderson responded to Knott's request by sending a standard form titled "Price Quotation" which included a statement that: "Our offer to supply product at the specified price is guaranteed for a period of 45 days from the date shown on this form." Anderson's sales manager signed the form and dated it September 1.

Banks submitted a written bid for the plumbing and electrical work. Banks's president signed the bid form, which provided that: "In consideration for being

included among the subcontractors that Knott Builders is evaluating for use on this project, we make this offer to perform the specified mechanical work guaranteed for acceptance no later than October 15.”

Finally, on the night before Knott’s bid on the general contract was due, Carter phoned the president of Knott with a bid for the countertop installation work. The price that Carter quoted for this phase of the project was \$1,500, less than one-half of the lowest quote that Knott received from other bidders. The other bids ranged from \$3,150 to \$3,800.

Knott then used Anderson’s, Banks’s, and Carter’s bids in computing its own bid on the full project. On September 12, the property owner awarded the contract to Knott. During the ensuing two weeks, Knott phoned and emailed several other suppliers and contractors in Richmond and Charlottesville to inquire whether they might be able to supply the needed products and services at a lower cost.

On September 26, Knott called Anderson, Banks, and Carter intending to accept their offers. Before he could communicate his acceptance, however, all three withdrew their bids. They explained that the market for kitchen renovations had recently become extremely active and prices were rising rapidly.

Anderson then offered to supply the countertops at a price 15% higher than its original quote. Banks offered to do the plumbing and electrical work for a 20% premium over its original quote.

Carter explained that he had made an error in transcribing his original bid and that he had intended for the price to be \$3,500. In any event, Carter told Knott that he was now too busy to do the work at all. Knott subsequently contacted several other local installers and found one willing to do the countertop installation for \$3,300. Kevin Knott, the president of Knott Builders, has called to ask for our firm’s advice. Helen Hayes, your supervising partner, wants to meet with you tomorrow afternoon

to have a preliminary discussion about the case. Please analyze whether Knott can enforce the bids from Anderson, Banks, and Carter.

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## **Preparing for Class – Revocation and Firm Offers**

What benefits might offerors get from making an irrevocable offer? Why is the option that an irrevocable offer creates so valuable? What limits do we need to impose on the creation of irrevocable offers? The purpose of this section is to give you the tools to answer these questions. You should also consider how courts apply the doctrinal rules for firm offers and evaluate the pros and cons of various approaches from the perspective of a business person.

Reflect on The Problem of the General Contractor and consider how business people use firm offers to facilitate commercial transactions.

It will be invaluable for you to reflect carefully on the extent to which your answer focused on the key doctrinal issues and offered a complete and compelling analysis of those issues. You may also need to revisit the readings and screencast lecture video to ensure that you have fully comprehended the structure of these doctrines and their practical application.

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## **4. UCC Section 2-207**

Recall our analysis of the hypothetical car sale negotiation between Airport Motors and Wheels for Less. As you read the next principal case, try to identify the provision of UCC § 2-207 that could give Wheels for Less a chance to obtain the warranty protection that it seeks.

### **4.1 *Ionics v. Elmwood Sensors, Inc.***

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Please read *Ionics v. Elmwood Sensors, Inc.* in your volume of Principal Cases.

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#### 4.1.1 The Text of UCC § 2-207

Uniform Commercial Code § 2-207 is one of the most intricate and (arguably) poorly drafted provisions of the code. Here is the current version of the section along with its official comments.

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Please read UCC § 2-207.

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#### 4.1.2 Additional and Different Terms Under § 2-207

One of the (many) textual anomalies in § 2-207 is the fact that the first sentence of the section refers to “terms additional to or different from” the offer while the second sentence refers only to “[t]he additional terms.” What has happened to the “different” terms of the first sentence? More importantly, what should courts do when they confront forms containing not only “additional” but also “different” terms? The following excerpt from a Rhode Island case discusses several possible approaches to this question:

Courts have taken three divergent approaches to this question. . . . In brief the first approach treats “different” terms as a subgroup of “additional” terms. The result is that such different terms, when material, simply do not become part of the contract and thus the original delivery term offered [by offeror] would control. The second approach reaches the same result by concluding that “the offeror’s terms control because the offeree’s different terms merely fall out [of the contract]; § 2-207(2) cannot rescue the different terms since that subsection applies only to additional terms.” Finally, the third approach, aptly named the “knock-out rule,” holds that the conflicting terms cancel one another, leaving a blank in the contract with respect to the unagreed-upon term that would be filled with one of the UCC’s “gap-filler” provisions. . . .

After due consideration we conclude that both prudence and the weight of authority favor adoption of the knock-out rule as the law of

this jurisdiction. . . . We conclude that this approach best promotes the UCC’s aim to abrogate the criticized common-law mirror image rule and its attendant last-shot doctrine and avoids “re-enshrin[ing] the undue advantages derived solely from the fortuitous positions of when a party sent a form.” Because of the UCC’s gap-filling provisions, we recognize that this approach might result in the enforcement of a contract term that neither party agreed to and, in fact, in regard to which each party expressed an entirely different preference. We note in response to this concern that the offeror and the offeree both have the power to protect any term they deem critical by expressly making acceptance conditional on assent to that term. And as merchants, both parties should have been well aware that their dealings were subject to the UCC and to its various gap-filling provisions.

*Superior Boiler Works, Inc. v. R.J. Sanders, Inc.*, 711 A.2d 628 (R.I. 1998).

*Questions for discussion of Ionics:*

*Ionics* presents a comparatively simple application of § 2-207. How exactly do the provisions of that section apply to this case?

Can you identify the three main routes to a binding contract under § 2-207? How do they each differ from one another?

Finally, do you see the problem with applying § 2-207 to cases involving “different” terms? Which of the possible approaches to “different” terms would you favor?

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View the screencast video on [Mirror Image and Last Shot Doctrine](#).

View the screencast video on [Intro to UCC 2-207](#).

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## **Preparing for Class – UCC § 2-207**

The common law mirror image rule and particularly the last shot doctrine create perverse incentives for parties to engage in a so-called "battle of the forms." In response to this problem, common law courts frequently struggle to construe parties' actions as something other than an acceptance of the last offer on the table. The drafters of the Uniform Commercial Code tried to create a statutory solution to this problem. You should try to internalize the complex provisions of UCC § 2-207 and work to unravel some of the interpretive anomalies that section presents.

Consider what to do about the problem of "different terms" under UCC § 2-207(2). Also, try to identify some of the policy considerations relevant to evaluating the approach of the Uniform Commercial Code as compared to the common law.

This topic is almost certainly the most technical doctrine that we have considered so far. You should surely review these materials several times to increase your command of the relevant doctrinal details. Also don't hesitate to ask questions about any aspect of the material that you find confusing. Finally, note that the next readings implicate both the common law and UCC approaches to contract negotiations. You can use those fact patterns to apply your developing understanding of these doctrines.

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## **5. Frontiers of Contract Formation**

When parties negotiate face to face and memorialize their agreement in a signed writing, courts have little difficulty with the issue of contract formation. The previous sections have introduced a variety of complications. In each case, the parties' communications were incomplete, contradictory, or inconclusive in some significant way. In this final section, we examine cases at the very frontier of traditional notions of contract formation. How should courts respond to so-called "shrink-wrap" or "click-wrap" licenses that purport to bind purchasers when they open a package or click through an online web purchase form? What should courts do



to regulate the timing of contract formation? Are sellers free to structure transactions so that the contract is formed and its terms determined some days or weeks after delivery?

The next two principal cases address these and other questions. As you read, consider how both common law and UCC rules would apply to these facts. Think also about what rules you believe ought to apply to transactions like these.

### **5.1 *Step-Saver Data Systems v. Wyse Technology***

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Please read *Step-Saver Data Systems v. Wyse Technology* in your volume of Principal Cases.

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### **5.2 *Hill v. Gateway 2000***

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Please read *Hill v. Gateway 2000* in your volume of Principal Cases.

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#### **5.2.1 Note on *ProCD v. Zeidenberg***

In *Hill v. Gateway*, Judge Easterbrook relies heavily on *ProCD v. Zeidenberg*, an earlier decision of the Seventh Circuit that addressed a similar problem of shrink-wrap licenses. Here is an excerpt that summarizes the court's reasoning in that case:

Must buyers of computer software obey the terms of shrinkwrap licenses? The district court held not [because] they are not contracts because the licenses are inside the box rather than printed on the outside. [W]e disagree with the district judge's conclusion. Shrinkwrap licenses are enforceable unless their terms are objectionable on grounds applicable to contracts in general (for example, if they violate a rule of positive law, or if they are

unconscionable). Because no one argues that the terms of the license at issue here are troublesome, we remand with instructions to enter judgment for the plaintiff.

According to the district court, the UCC does not countenance the sequence of money now, terms later.... To judge by the flux of law review articles discussing shrinkwrap licenses, uncertainty is much in need of reduction—although businesses seem to feel less uncertainty than do scholars, for only three cases (other than ours) touch on the subject, and none directly addresses it. [T]hese are not consumer transactions. Step-Saver is a battle-of-the-forms case, in which the parties exchange incompatible forms and a court must decide which prevails. Our case has only one form; UCC § 2-207 is irrelevant.

What then does the current version of the UCC have to say? We think that the place to start is § 2-204(1): “A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.” A vendor, as master of the offer, may invite acceptance by conduct, and may propose limitations on the kind of conduct that constitutes acceptance. A buyer may accept by performing the acts the vendor proposes to treat as acceptance. And that is what happened. ProCD proposed a contract that a buyer would accept by using the software after having an opportunity to read the license at leisure. This Zeidenberg did. He had no choice, because the software splashed the license on the screen and would not let him proceed without indicating acceptance. So although the district judge was right to say that a contract can be, and often is, formed simply by paying the price and walking out of the store, the UCC permits contracts to be formed in other ways. ProCD proposed such a different way, and without protest Zeidenberg agreed. Ours is not a case in which a consumer opens a package to find an insert saying “you owe us an extra \$10,000” and the seller files suit to collect. Any buyer finding such a demand can prevent formation of the contract by returning the package, as can any consumer who concludes that the terms of the license make the

software worth less than the purchase price. Nothing in the UCC requires a seller to maximize the buyer's net gains.

*ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1449 (7th Cir. 1996).

*Questions for discussion of Step-Saver and Hill v. Gateway:*

One way to think about these transactions distinguishes five stages of the parties' interaction:

- (1) Preliminary contacts
- (2) Order and payment
- (3) Shipment of the product
- (4) Opening the package and installation
- (5) Use of the product

In each case, the terms that lead to legal disputes appear only at stage (4).

What is the earliest stage at which we could say that a contract has been formed? The latest stage?

Applying common law rules, what would be the contract terms under the earliest and latest possible times of formation? How would a court resolve the same issues under UCC § 2-207?

What are the strongest arguments that the seller should prevail under both the common law and the UCC?

Are you more sympathetic to Judge Wisdom's approach in *Step Saver* or Judge Easterbrook's approach in *Hill v. Gateway*?

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## Preparing for Class – Frontiers of Contract Formation

Now that you are starting to feel familiar with the intricacies of UCC § 2-207, the materials in this section test your understanding and challenge you to develop and defend a policy position about common contract practices such as shrink-wrap and click-wrap licenses.

You should reflect on the following questions:

- Where do we find the terms that lead to these disputes?
- When could we say that a contract has been formed? Earliest? Latest?
- Under common law rules, what would be the contract terms for these two alternatives? (Of course, this is just an exercise since the contract is for the sale of goods.)
- Under UCC § 2-207, how would the same issues be resolved?
- Is click-wrap enough to indicate agreement?
- What about signing with your email address and submitting an online software registration form?
- How about keeping a product after the return period has expired?
- What should we require?

Think about these questions and consider the legal policies that influence the doctrines we have been considering.

Continue to reflect on these issues and perhaps try to find ways that the legal rules governing contract formation apply to your own life. Does your own behavior in relation to click-wrap and shrink-wrap licenses support or undermine the case for Judge Wisdom's or Judge Easterbrook's approach to these agreements?

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## **IV. DEFINING THE OBLIGATION TO PERFORM**

We have thus far focused on the rules that determine whether the parties have made an enforceable contract. Our attention now shifts to the question of performance. What conduct will be sufficient to fulfill each party's obligation under the contract? Are there circumstances that might excuse performance?

### **1. Excuse**

When we make or receive promises, we understand that there are at least some circumstances that will extinguish the resulting obligation to perform. In social settings, a "good excuse" exists whenever an unexpected contingency prevents someone from fulfilling her promise. If Sharon has agreed to give several friends a ride to a concert, mechanical trouble with her car excuses her from a duty to drive, but not from a duty to tell her friends promptly about her inability to drive. If, however, Sharon is seriously injured in a car accident on the way to pick up her friends, no one would condemn her for failing to call.

What is it about our understanding of Sharon's promise that allows us to make these nuanced judgments about responsibility? Notice first that the words of the promise itself play no role in establishing that mechanical trouble would excuse performance or in distinguishing between the consequences of mechanical trouble and personal injury. Sharon made an unqualified promise to drive her friends to the concert, and no one expects her to recite a litany of circumstances in which she will be unable to perform. Instead, we rely on a shared understanding about what events justify nonperformance.

Commercial agreements ordinarily involve comparatively complex obligations. Their express terms likewise cover a wider array of contingencies. However, no contract can possibly provide for every event that might occur between the execution of the contract and the time for performance. In the two cases that follow, consider carefully the role of contractual language in allocating the risks of unexpected contingencies. Try to develop a theory that can explain and perhaps justify the results in these cases.

## 1.1 *Steas v. Leonard*

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Please read *Steas v. Leonard* in your volume of Principal Cases.

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### *Questions for discussion:*

The owners allegedly promised to keep the soil drained but failed to do so. Why did the *Steas* court refuse to entertain the argument that the owners' promise had modified the original contract or that the builder had relied on that promise to its detriment?

What exactly did the contract in this case require the builder to do?

Did the parties discuss or negotiate over the possibility that the soil might be unable to support the building?

Try applying the comparative advantage criterion to this situation. Can you think of arguments that would support imposing the risk of poor soil conditions on the owner? On the builder?

## 1.2 *Taylor v. Caldwell*

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Please read *Taylor v. Caldwell* in your volume of Principal Cases.

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### 1.2.1 Note on *Paradine v. Jane*

Suppose that a rich Englishman rents a castle from a neighboring lord. Their brief lease agreement specifies a four-year term and a rental rate. It also makes the lessee responsible for ordinary maintenance during the term of the lease. Imagine now that the armies of Prince Rupert occupy the region and force the lessee to leave

the property. Would the lessee be excused from paying rent during the occupation? Or is the lessor entitled to receive rental payments until the end of the lease term?

Here is what one court had to say about these questions:

[I]f a house be destroyed by tempest, or by enemies, the lessee is excused.... [W]hen the party by his own contract creates a duty or charge upon himself, he is bound to make it good, if he may, notwithstanding any accident by inevitable necessity, because he might have provided against it by his contract. And therefore if the lessee covenant to repair a house, though it be burnt by lightning, or thrown down by enemies, yet he ought to repair it. Dyer 33.a. 40 E.3. 6.h. ... Another reason was added, that as the lessee is to have the advantage of casual profits, so he must run the hazard of casual losses, and not lay the whole of the burthen of them upon his lessor; and Dyer 56.6 was cited for this purpose, that though the land be surrounded, or gained by the sea, or made barren by wildfire, yet the lessor shall have his whole rent: and judgment was given for the plaintiff.

*Paradine v. Jane*, Aleyn 26, 82 Eng. Rep. 897 (K.B. 1647).

### 1.2.2 Analyzing Risk as Expected Value

Economists and businesspeople often analyze contingencies using the framework of expected value. According to this approach, the magnitude of a risk (R) equals the product of its impact (I) and the probability (P) that the particular risk will materialize. The formula  $R = I \cdot P$  summarizes this relationship and suggests the analytic usefulness of identifying these distinct components of risk.

Legal analysis of risk allocation often requires even more detailed attention to each party's relationship with a particular risk. Consider, for example, the risk discussed in *Taylor v. Caldwell* that a shipment of turpentine will be burned at the docks before it reaches the purchaser. It may be helpful to think of three broad factors affecting the optimal allocation of this risk between the parties. First, which one of the parties is best able to *assess* the risk of fire? Who has better access to information or can gather relevant information at lower cost? Second, which party is best positioned to *avoid* the risk? Who can more cheaply take precautions to reduce the

impact or probability of harm? Finally, which party could most easily *insure* against the risk?

*Questions for discussion of Taylor v. Caldwell:*

On what basis does the *Taylor* court decide to excuse Caldwell from performing his contractual obligation to provide the Surrey Gardens and Music Hall to Taylor? The court must decide how to allocate the risk that the music hall would be burned down before the first concert. Does the contract language play any role in the court's decision? If not the contract language, then what is the source of the court's rule for allocating this risk?

Suppose that one of your talented classmates contracts with you to provide high quality class notes covering each meeting of all of your first-semester courses. Tragically, this classmate dies before she has an opportunity to perform. How might the risk analysis framework outlined above apply to this risk? Are you or your classmate in a better position to assess, avoid or insure against the risk of her untimely demise? Is it helpful to consider separately the impact and probability of her death?

Does a similar analysis shed any light on how to allocate the risk that materialized in *Taylor v. Caldwell*? Can we draw any conclusions from this analysis about how to choose the socially optimal legal rule to govern excuse?

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View the screencast video on the [Excuse Doctrine](#).

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### **Preparing for Class – Excuse**

Even after parties have formed an enforceable contract, contingencies can arise that may excuse them from performing what they have promised. The doctrines of impossibility, commercial impracticability and frustration of purpose determine whether or not a particular change of circumstances will excuse performance. Courts ordinarily engage in a sort of categorical reasoning, matching the facts of each case to



various paradigmatic fact patterns in which previous decisions have granted or denied a plea for excuse. Underlying these categories, however, is a somewhat more complicated version of our familiar comparative advantage (or hypothetical bargain) analysis.

Recall the court's reasoning in *Steas v. Leonard* and answer the following questions:

1. What does the court say is its role?
2. According to the court's opinion, what justifies imposing liability on the builder?
3. What could the builders have done to protect themselves against liability?
4. From what source does the court derive the idea that performance should be excused if it is physically impossible?
5. What exactly did the contract require the builders to do?
6. What happened when the builders tried to construct the building according to the plans and specifications?
7. What does the court suggest that the builders should have done when they discovered the problems with the soil?
8. Was the contract language drafted to memorialize an agreement that the parties negotiated about the risk that the soil was quicksand?
9. And finally, note that the court chides the builders for failing to include language protecting themselves against the risk of bad soil conditions. How could the court have made a symmetrical contract drafting argument about the owners?

Try to apply a comparative advantage analysis to the facts of *Steas v. Leonard*, to the textbook personal service contract hypo, and to the situation in *Taylor v. Caldwell*.

You may find it helpful to look backward to see how our comparative advantage analysis of excuse doctrines compares to our use of the comparative advantage criterion in other doctrinal areas that we have already studied. I also

encourage you to bear these excuse doctrines in mind as we begin to consider the problem of mistake and the rules governing misrepresentation and non-disclosure.

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## 2. Mistake

We have already encountered contract doctrines that excuse performance when certain contingencies arise. In *Steas v. Leonard*, for example, the court observes that performance would have been excused if it were physically impossible to complete the building. Similarly, the court in *Taylor v. Caldwell* finds that the destruction of property necessary for performance excuses both parties' duties under the contract. The doctrine of commercial impracticability modestly extends these principles to excuse a promisor when performance "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." UCC § 2-615. *See also* Restatement (Second) of Contracts § 261 ("Discharge by Supervening Impracticability"). Finally, the common law also excuses performance when "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." Restatement (Second) of Contracts § 265. Taken together, these doctrines establish a set of default rules for allocating the risk of events that make performance more difficult or impair the value of performance. However, the parties remain free to opt out of this default risk allocation by including appropriate language in their contract.

The rules governing unilateral and mutual mistake that we examine in this section are another example of default risk allocations. In these cases, one or both of the parties has made a contract based on a mistaken belief about important facts. As with the excuse doctrines, the parties may opt out with express language allocating the risk. Disputes most often arise, however, when neither party has anticipated the particular mistake and provided for it in the contract. As you read the cases that follow, try to determine what policy concerns affect the structure of these default rules. Before you tackle the cases, it will be helpful to familiarize yourself with the Restatement sections on mistake.

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Please read sections 151-154 of the RESTATEMENT (SECOND) OF CONTRACTS.

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## 2.1 *Sherwood v. Walker*

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Please read *Sherwood v. Walker* in your volume of Principal Cases.

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### 2.1.1 The Story of *Sherwood v. Walker*

A law review article provides a wealth of background information about the parties (and the cow) involved in *Sherwood v. Walker*. It appears that Hiram Walker, the seller, was the moving force behind the famous brand of Canadian Club Whiskey, and the buyer Theodore Clark Sherwood was a prominent banker who went on to found a financial institution that eventually became a part of Bank One. We also learn from the article that after losing in the Michigan Supreme Court, Sherwood purchased Rose the 2d from Walker for an undisclosed price. See Norman Otto Stockmeyer, *To Err Is Human, To Moo Bovine: The Rose of Aberlone Story*, 24 THOMAS COOLEY L. REV. 491 (2007).

### 2.1.2 Note on *Lenawee County Bd. of Health v. Messerly*

In a subsequent case, *Lewanee County Bd. of Health v. Messerly*, 331 N.W.2d 203 (Mich. 1982), the Michigan Supreme Court had occasion to revisit the *Sherwood v. Walker* decision and expressed its frustration with the distinction the earlier case had drawn between mistakes that go to the “essence of the consideration” from those affecting merely its “quality or value.” The court had this to say about the *Sherwood* opinion:

[*Sherwood*] arguably distinguishes mistakes affecting the essence of the consideration from those which go to its quality or value, affording relief on a per se basis for the former but not the latter. . . . However, the distinctions which may be drawn from *Sherwood* . . . do not

provide a satisfactory analysis of the nature of a mistake sufficient to invalidate a contract. Often, a mistake relates to an underlying factual assumption which, when discovered, directly affects value, but simultaneously and materially affects the essence of the contractual consideration. It is disingenuous to label such a mistake collateral. . . . [The parties in this case] both mistakenly believed that the property which was the subject of their land contract would generate income as rental property. The fact that it could not be used for human habitation deprived the property of its income earning potential and rendered it less valuable. However, this mistake, while directly and dramatically affecting the property's value, cannot accurately be characterized as collateral because it affects the very essence of the consideration. . . . We find that the inexact and confusing distinction between contractual mistakes running to value and those touching the substance of the consideration serves only as an impediment to a clear and helpful analysis for the equitable resolution of cases in which mistake is alleged and proven. Accordingly, the [holding of *Sherwood* is limited to the facts of that case.]

In *Messerly*, the parties' contract included an express "as is" clause. The following passage shows how such a clause is relevant to analyzing under Restatement (Second) § 154 whether the risk of mistake has been allocated to one of the parties.

In cases of mistake by two equally blameless parties, we are required, in the exercise of our equitable powers, to determine which blameless party should assume the loss resulting from the misapprehension they shared. Normally that can only be done by drawing upon our "own notions of what is reasonable and just under all the surrounding circumstances. . . ." Equity suggests that, in this case, the risk should be allocated to the purchasers. We are guided to that conclusion, in part, by the standards announced in § 154 of the Restatement of Contracts, [Second], for determining when a party bears the risk of mistake. . . . Section 154(a) suggests that the court should look first to whether the parties have agreed to the allocation of the risk between themselves. While there is no express assumption in the contract by

either party of the risk of the property becoming uninhabitable, there was indeed some agreed allocation of the risk to the vendees by the incorporation of an “as is” clause into the contract.... [The incorporation] of this clause is a persuasive indication that, as between them, such risk as related to the “present condition” of the property should lie with the purchaser. If the “as is” clause is to have any meaning at all, it must be interpreted to refer to those defects which were unknown at the time that contract was executed.

*Id.* at 31–32.

Despite the *Messerly* court’s disapproval of the reasoning in *Sherwood*, Professor Stockmeyer notes that *Sherwood* remains a staple of Contracts casebooks and treatises. He also defends the case’s vitality as legal authority in Michigan. Stockmeyer concludes:

Perhaps most tellingly of all, in a 2006 mutual mistake case, *Ford Motor Co. v. Woodhaven*, a unanimous Michigan Supreme Court discussed *Sherwood* at length, ignored [*Messerly*] completely, and announced that Rose’s case was still viable: “Our review of our precedents involving the law of mistake indicates that the peculiar and appropriate meaning that the term ‘mutual mistake’ has acquired in our law has not changed since *Sherwood*.”

Stockmeyer, *supra*, at 501-02.

Although Stockmeyer’s account is correct as far as it goes, *Ford Motor Co. v. Woodhaven* may tell us less about the law of mistake in Michigan than he supposes. The *Ford Motor* court relies explicitly on the *Sherwood* majority’s understanding of the facts—particularly their highly questionable assertion that neither of the parties to the sale contract thought that Rose could be made to breed. With this important limitation in mind, it is perhaps more accurate to say that *Ford Motor* reaffirmed an uncontroversial proposition: If two parties are both mistaken about a fundamental attribute of the good they are exchanging, then the doctrine of mutual mistake makes it possible to argue for rescission. As our discussion of *Sherwood v. Walker* will reveal, however, the majority’s opinion also makes far less defensible claims about the parties’ beliefs and about the importance of a distinction between the “substance”

and a mere “quality” of the item being exchanged. The *Ford Motor* court has nothing whatsoever to say about these more controversial aspects of *Sherwood*.

*Questions for discussion of Sherwood v. Walker:*

What is the best argument that you could make on behalf of Walker (the seller)?

How would you argue the case for Sherwood?

Was this case correctly decided?

## **2.2 *Anderson v. O’Meara***

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Please read *Anderson Brothers Corp. v. O’Meara* in your volume of Principal Cases.

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*Questions for discussion:*

What is the best way to frame the case for Anderson (the seller)?

Does the testimony recounted in footnotes 4 and 5 present any problem for your argument?

How might you respond to the buyer’s reliance on this testimony?

How do the relevant Restatement sections apply to this case?

Are there any provisions of the Restatement that permit a court to use a comparative advantage analysis in this situation?

### **2.2.1 Hypo of the Sterile Calf**

Suppose that Max Backus, a Texas cattle breeder, attends a livestock auction in search of promising breeding stock. He purchases one Rob of Aberdeen, a 16-day old bull calf for a price of \$5,000. The minimum age at which the fertility of a bull

can be determined is about one year. When the calf is 18 months old, veterinary tests establish conclusively that the calf was incurably sterile at birth. If the parties had known about the calf's condition, Rob would have been worth only \$30 at the time of the auction.

Backus now seeks rescission of the sale contract. What arguments would you expect the parties to make and what is the most likely outcome of the case?

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View the screencast video on [Mistake](#).

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### **Preparing for Class – Mistake**

What do you suppose happens when one (or both) of the parties to a bargain suffers from a mistaken belief about some important aspect of the deal? You might initially imagine that courts would be unreceptive to claims for relief from contractual obligations. Judges could well say the risk that you've made a mistake is simply one of the risks a promisor assumes when they assent to a contract. Courts might reasonably worry that allowing parties to seek rescission for mistake will invite them to claim a mistake whenever they find performance difficult or unrewarding.

At the same time, contractual obligations are founded on parties' informed consent to a bargain. A significant mistake could vitiate that consent and would also raise doubts about whether enforcement will produce any gains from trade. Thus, a court might be willing to entertain an argument for rescission if the basis for that claim can be defined narrowly enough to avoid unduly undermining the stability and certainty of contractual promises.

Practice drawing the line between legitimate claims for rescission and opportunistic efforts to avoid performing one's contractual obligations.

Try to apply both the formal doctrinal rules and the broader comparative advantage criterion to the facts of *Sherwood v. Walker*, *Anderson v. O'Meara*, and the hypo of the sterile calf.

When we later study the rules governing misrepresentation and non-disclosure, be particularly attentive to the overlap and the parallels between those doctrines and the law of mistake. I would also encourage you to review our analysis of *Sherwood v. Walker* quite closely because that case illustrates a number of themes that will also shape our analysis of non-disclosure.

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### **3. Substantial Performance**

#### **3.1 *Jacob & Youngs v. Kent***

The following case involves a dispute about the brand of pipe installed in the defendant's newly constructed "country residence." As you read the case, consider what the defendant might have done differently to ensure that the court would respect his professed desire for Reading pipe.

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Please read *Jacob & Youngs v. Kent* in your volume of Principal Cases.

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##### **3.1.1 Perfect Tender and Substantial Performance**

Under the Uniform Commercial Code, the standard for performance is "perfect tender" rather than "substantial performance."

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Please read UCC § 2-601.

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This rule applies to contracts for the sale of "goods" as defined in the UCC. Thus, with the exception of the seller's limited right to "cure" a defective tender under UCC § 2-508, buyers of goods may reject a seller's performance for even a minor failure to conform to the description or quality of the goods specified in the contract.



In contrast, the doctrine enunciated in *Jacob & Youngs v. Kent*, allows a promisor to provide “substantial performance” and pay damages for any “trivial and innocent defects.” Courts ordinarily apply this doctrine to complex service and construction contracts.

### **3.1.2 Motion for Rehearing in *Jacob & Youngs v. Kent***

According to the record on appeal in *Jacob & Youngs v. Kent*, the contract with the builder included the following language:

Any work furnished by the Contractor, the material or workmanship of which is defective or which is not fully in accordance with the drawings or specifications, in every respect, will be rejected and is to be immediately torn down, removed and remade or replaced in accordance with the drawings and specifications, whenever discovered.... The Owner shall have the option at all times to allow the defective or improper work to stand and to receive from the Contractor a sum of money equivalent to the difference in value of the work as performed and as herein specified.

After losing on appeal, Kent filed a motion for rehearing and called the court’s attention to this clause. The New York Court of Appeals responded with a brief *per curiam* opinion:

The court did not overlook the specification which provides that defective work shall be replaced. The promise to replace, like the promise to install, is to be viewed, not as a condition, but as independent and collateral, when the defect is trivial and innocent. The law does not nullify the covenant, but restricts the remedy to damages.

230 N.Y. 656 (1921).

*Questions for discussion of Jacob & Youngs v. Kent:*

Suppose that, contrary to fact, a rule of perfect tender applied to construction contracts. If you were negotiating an agreement on behalf of a builder, what risks would you anticipate? What contract terms might you propose to the owner in order

to protect your client from those risks? How might the owner's willingness to agree to vary the perfect tender rule affect the price the builder should charge for the project?

Now imagine how the same negotiation would proceed under the rule of substantial performance. Suppose that the owner cares deeply about having Reading rather than Cohoes or National pipe. Can you propose contract language that would ensure that the builder must tear out and replace any non-Reading pipe? Are there any additional terms that the parties could include in their contract to protect the builder from the special risks associated with promising to use only Reading pipe?

Judge Cardozo argues for a rule that permits the builder to avoid the high cost of tearing out and replacing nonconforming pipe because the defect is "both innocent and trivial." The owner must be content with receiving damages for the difference in market value between Reading and other brands of pipe. In his dissent, Judge McLaughlin casts the builder's conduct in a different light and advocates strict application of the contract specifications. What incentives do these competing rules create for builders and owners? Could a court devise what we have called a "compound liability rule" that polices potential misconduct by both parties?

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View the screencast video on [Substantial Performance](#).

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## **Preparing for Class – Substantial Performance**

Are there circumstances in which a promisee must be content with less than strictly complete performance? As you have seen in this section, courts sometimes invoke the doctrine of substantial performance not to excuse less than full performance but instead to limit the promisee's remedy to recovery for any difference in value resulting from an "innocent and trivial" defect. Somewhat like the rules governing the enforcement of construction bids that we studied in *Pavel Enterprises*, substantial performance doctrine looks in two directions at once. It tries to prevent owners from taking undue advantage of insubstantial errors, and it also aims to police contractors who might abuse the doctrine by substituting cheaper materials or being less careful about the details of construction.

You may want to think about how substantial performance doctrine is similar to and different from the rule of *Drennan v. Star Paving* and § 87(2) that we applied to construction bidding in *Pavel*. In addition, bear our discussion in mind when we later study the contract remedy doctrines that distinguish between the value of performance and the cost of performance as the proper measure of damages.

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## V. REGULATING THE BARGAINING PROCESS

### 1. Unconscionability

Consider for a moment what might justify using the coercive power of the state to enforce private promises. From a moral perspective, we might think that choosing to make a promise creates a duty to perform. Imagine that Cheryl promises Albert that she will prepare his tax return in exchange for \$200. The promisor Cheryl exercises her autonomy to establish a new relationship in which the promisee Albert can rely on her promise and adjust his plans accordingly. We show respect for the autonomy of both parties by enforcing the promise. Enforcement enables Cheryl to bind herself to perform if she chooses to do so. At the same time, enforcement respects Albert's autonomy by protecting his reliance on Cheryl's promise.

An alternative economic or "instrumental" approach to enforcement also focuses on the parties' choices and reliance. From an economic perspective, one goal of promise making is mutually beneficial trade. People make promises to enable others to rely. Promises also allow parties to trade risks. Thus, Cheryl assumes the risk that the market price for tax preparation will rise or that she will find it inconvenient or difficult to fulfill her promise to complete Albert's tax return by the filing deadline. At the same time, Albert accepts the risk that someone else will offer to do his taxes for less or that he would prefer to prepare the return himself. Each party faces a different bundle of risks than he or she did before making or receiving the promise. On this account, the purpose of promissory enforcement is to maximize the social benefits that flow from these exchanges of risk.

Both justifications for enforcement have in common the assumption that parties make promises and enter into bargains voluntarily. It follows that if Cheryl holds a gun to Albert's head and forces him to contract for her services, then Albert should be free to disavow the deal and use H&R Block instead. More difficult and subtle questions arise when a promisor claims that she lacked essential information about the terms of a bargain or that she was for some other reason unable to exercise a meaningful choice. Even more controversial are claims that the terms of the deal are so unfavorable that a court should simply refuse to enforce them.

The two opinions in the following case address some of these issues.

## 1.1 *Williams v. Walker-Thomas Furniture Co. I*

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Please read *Williams v. Walker-Thomas Furniture Co. I*  
in your volume of Principal Cases.

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## 1.2 *Williams v. Walker-Thomas Furniture Co. II*

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Please read *Williams v. Walker-Thomas Furniture Co. II*  
in your volume of Principal Cases.

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### 1.2.1 Procedural and Substantive Unconscionability

Both judges and scholars ordinarily draw a distinction between “substantive” and “procedural” unconscionability. *Substantive* unconscionability focuses on the contract terms themselves. This branch of the doctrine asks whether the terms of the agreement are so unfavorable to one of the parties that we should refuse enforcement. In this vein, courts may find that a manufacturer’s clause limiting remedies for breach is contrary to the “essence of the bargain” or that a price or warranty term in a consumer contract is “unreasonable.”

In contrast, *procedural* unconscionability focuses on the circumstances surrounding contract formation. Was there something about that process that prevented one party from understanding the agreement? Most courts consider a wide range of “factors related to the bargaining power of each party, including age, education, intelligence, business acumen, experience in similar transactions, whether the terms were explained to the weaker party, who drafted the contract, whether alterations in the printed terms were possible, and whether the party claiming unconscionability was represented by counsel at the time the contract was executed.” *Roe v. Rent-A-Center, Inc.*, CA2007-09-224 (Ohio App. 2008). For example, a court

might find an agreement procedurally unconscionable because a company's sales practices tended to obscure the true nature of the contract.

Each strand of unconscionability doctrine stands in some tension with other contract doctrines that favor the enforcement of all voluntary bargains. Thus, the "duty to read" doctrine holds that a person who signs a contract without reading it will be bound despite his lack of knowledge of its terms. Courts have even refused to excuse illiterate and non-English-speaking promisors, explaining that they should have asked someone to read and explain the agreement before signing it. *See, e.g. Morales v. Sun Constructors, Inc.*, No. 07-3806 (3d Cir. 2008); *Upton v. Tribilcock*, 91 U.S. 45 (1875). As we saw in *Williams I* and *Williams II*, a procedural unconscionability claim must first overcome judicial reluctance to depart from the strict "duty to read" precedents.

Similarly, arguments about substantive unconscionability conflict with the general contractual principle that courts should let the parties judge for themselves whether to accept a particular bargain. For example, courts do not scrutinize the adequacy of consideration. Each party is free to make a good bargain or a bad bargain, and judges ordinarily respect the private ordering these agreements seek to create. Finding a contract substantively unconscionable rejects the parties' bargain and prevents them from forming an enforceable agreement on those terms. Perhaps as a result of this fundamental tension, judicial decisions hardly ever invalidate an agreement solely on grounds of substantive unconscionability. And many jurisdictions formally require courts to find an agreement both procedurally and substantively unconscionable before refusing to enforce it. *See, e.g., Roe v. Rent-A-Center, Inc.*, CA2007-09-224 (Ohio App. 2008).

### **1.2.2 Rent-to-Own Industry and Consumer Protection Laws**

In *Williams I*, the court concluded its opinion by calling attention to questionable practices in the rent-to-own industry. Walker-Thomas's conduct evidently raised "serious questions of sharp practice and irresponsible business dealings." The court also issued a plea for "corrective legislation" along the lines of provisions contained in the Maryland Retail Installment Sales Act.

Some years later, *The Wall Street Journal* published a highly critical feature story on the rent-to-own industry. In extensive interviews, former Rent-A-Center

managers described high-pressure sales tactics, misleading pricing practices, and coercive methods of repossessing goods from defaulting renters. Repo calls sometimes included demands for “couch payments” —sexual favors extorted in lieu of cash. However, the article also revealed that many renters could not afford to buy the items and had “nowhere else to go.” See Alix Freedman, *Peddling Dreams: A Marketing Giant Uses Its Sales Prowess to Profit on Poverty*, THE WALL STREET JOURNAL A1 (Sept. 22, 1993).

More recently the industry has fought off efforts to enact legislation classifying rent-to-own transactions as credit sales. The typical “rental” agreement provides for total payments several times the normal retail value of the goods, and thus an implied annual interest rate of 200-300 percent. Redefining these deals as credit transactions would make state usury laws applicable and prohibit firms from charging such a high implicit interest rate. The industry argues, however, that rent-to-own customers assume no debt and always have an option to return the goods with no further obligation. Moreover, a 1999 Federal Trade Commission customer survey found that most are satisfied with their rent-to-own transactions. See John Seward, *Tales of the Tape: Rent-To-Owns Seek Definition in Law*, DOW JONES NEWSWIRES (Oct. 17, 2003).

In one respect at least, the *Williams I* court’s wish was fulfilled. The District of Columbia Code now contains a provision prohibiting the sort of pro-rata payment arrangement contained in Walker-Thomas Furniture Company’s contract. See D.C. Code § 28-3805. Under the statute, payments must be credited towards the first item purchased until that item has been paid off and the seller’s security interest in that item is then extinguished.

### **1.2.3 Uniform Commercial Code Unconscionability Provisions**

The Uniform Commercial Code empowers a court to refuse to enforce unconscionable contracts.

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Please read UCC § 2-302.

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*Questions for discussion of unconscionability:*

Why does the D.C. Court of Appeals (reluctantly) decide, in *Williams I*, to enforce the pro-rata payment clause in the Walker-Thomas Furniture Company's form contract?

The D.C. Circuit reaches a decidedly different decision about the prevailing legal rule. Does that court hold that the pro-rata-payment clause is unconscionable? If not, then what doctrinal standard will determine whether the clause is unconscionable?

Judge Wright talks extensively about unequal bargaining power. What do you suppose he means by that term?

Consider the following language from the Uniform Commercial Code provision concerning unconscionability: "The principle is one of the prevention of unfair surprise and not of disturbance of risks because of superior bargaining power." UCC § 2-302 Comment 1. Can you reconcile this comment with Judge Wright's discussion of bargaining power in *Williams II*?

The prospective effects of procedural and substantive unconscionability are likely to differ. How would you expect sellers to respond to a ruling that the Walker-Thomas Furniture Company's form contract is procedurally unconscionable? Suppose that a court instead holds that pro-rata-payment clauses and cross-collateral clauses are substantively unconscionable. Will people in Ms. Williams's circumstances be able to obtain furniture on the same payment plan?

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View the screencast video on [Unconscionability](#).

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## **Preparing for Class – Unconscionability**

We have turned now to a series of legal rules that each address in a different way aspects of the bargaining process. Cases applying unconscionability doctrine to void or reform a contract most often focus on a significant process defect that undermines the promisor's ability to understand the nature of their contractual

obligations. Far less commonly, courts sometimes use the doctrine to vindicate a public policy of protecting someone (usually a consumer) from oppressive terms.

Consider the best argument for Ms. Williams's claim that the furniture company's pro-rata payment clause is procedurally unconscionable. Also, try to apply unconscionability doctrine to the facts of *Batsakis v. Demotsis*. Compare the prospective effects of procedural and substantive unconscionability rulings. Finally, consider whether courts or legislatures are better suited to establish these important legal policies.

Always bear in mind that unconscionability is a disfavored legal argument. Both in practice and on exams, it should be your last resort rather than the first approach that springs to your mind. Its use is most common in some consumer contract disputes and, increasingly, in cases challenging the enforceability of mandatory arbitration clauses like the one we saw in *Hill v. Gateway*. Even in these core areas of application, the argument is seldom successful.

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## 2. Modification

In this section, we examine the rules that apply when parties choose to modify existing contractual obligations. The traditional common law approach held that a modification would be ineffective without fresh consideration—some obligation beyond what the promisor was already obliged to perform under the prior contract. This “pre-existing duty rule” established a comparatively precise bright-line rule for evaluating attempted modifications. The *Alaska Packers* case that follows arguably illustrates this traditional approach.

More recent decisions, however, have shown a willingness to enforce modifications even when a promisor assumes no new obligations. The Restatement (Second) of Contracts embraces a rather open-ended standard incorporating both reliance-based enforcement and general equitable principles.

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Please read section 89 of the RESTATEMENT (SECOND) OF CONTRACTS.

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The Uniform Commercial Code adopts a very similar standard based on good faith.

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Please read UCC § 2-209 and the official comments accompanying that section.

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Both the Restatement and this UCC provision abandon the comparatively precise pre-existing duty rule. They instead invite parties to present evidence about the circumstances surrounding their agreement to modify the prior contract and require courts to evaluate modifications under relatively amorphous standards of equity and good faith.

Even under the traditional pre-existing duty rule, one possible alternative was to rescind the existing contract and form a new one. Termed a “substituted contract” or sometimes a “novation,” the new contract is enforceable because the parties have terminated the prior contract and discharged any obligations that it imposed. If courts routinely enforced any agreement that parties denominated a substituted contract or novation, the strict pre-existing duty rule would be eviscerated and replaced with an equally clear rule allowing parties to modify existing contractual obligations without any legal constraint. However, this strategy must overcome judges’ reluctance to permit a purely formal device to eliminate substantive doctrinal constraints. To prevent parties from elevating form over substance, courts may construe a purported substitution or novation as an attempt to modify the prior contract and then apply the ordinary constraints on modification.

As you read the case that follows, consider whether the court applies the comparatively clear pre-existing duty rule. Or does the opinion examine the surrounding circumstances to determine whether to enforce the modified contract?

## **2.1 Principal Case – *Alaska Packers’ Association v. Domenico***

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Please read *Alaska Packers’ Association v. Domenico*  
in your volume of Principal Cases.

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### **2.1.1 The Story of *Alaska Packers***

Academic commentary about *Alaska Packers* varies quite considerably. Professor (now Judge) Richard Posner sees a standard holdup story:

This seems a clear case where the motive for the modification was simply to exploit a monopoly position conferred on the promisors by the circumstances of the contract. It might seem that the promisor would have been in worse shape if the men had quit as they threatened to do. However, since their only motive for threatening to quit was to extract a higher wage, there was probably little danger of their actually quitting. The danger would have been truly negligible had they known that they could not extract an enforceable commitment to pay them a higher wage.

Richard Posner, *Gratuitous Promises in Economics and Law*, 6 J. LEGAL STUD. 411 (1977).

Professor Debora Threedy identifies a different motivation entirely. She describes the salmon fishing industry in some detail and points out that the fisherman contended at trial that the company had supplied them with substandard nets, which would have made it more difficult to catch fish and thus to earn the piece rate compensation of \$0.02 per salmon caught. Although the trial court ultimately rejected this allegation, Threedy suggests that the fishermen may have believed the nets were substandard. This belief could have justified their demand to renegotiate their contract. See Debora Threedy, *A Fish Story: Alaska Packers' Association v. Domenico*, 2000 UTAH L. REV. 185.

### **2.1.2 Hypo on Modification**

Consider a contract under which a farmer promises to deliver 1,000 bushels of wheat to a miller on November 1<sup>st</sup> at \$15 per bushel. Imagine two possible modification scenarios:

Case A – The farmer suffers a drought that diminishes and delays his harvest. He asks for a delay in the delivery date and an increase in the price (to \$17/bushel) to cover his added costs.

Case B – The spot price for wheat rises steadily. The farmer waits until just before the scheduled delivery date and then demands that the miller agree to pay the current spot price (\$17/bushel) rather than the contract price.

In which of these situations does the modification seem to be in good faith?

*Questions for discussion of Alaska Packers:*

Notice that the court in *Alaska Packers* repeatedly refers to the substantial investment that appellant had in its cannery facility. Why is this information relevant to determining whether the modification is enforceable?

Try analyzing the facts of *Alaska Packers* under the standards of the Restatement and the UCC. Can you tell different stories about the case that might lead to enforcement or non-enforcement of the modified contract?

Consider the problem of modification as a game. Could a promisor benefit from being unable to agree to an enforceable modification? Are there any circumstances in which this inability might harm the promisor?

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View the screencast video on [Modification](#).

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## **Preparing for Class – Modification**

During the performance of a contract, circumstances sometimes arise that make the parties wish to adjust their obligations. If they are able to agree on a modification, we might think that their manifestation of mutual assent would be sufficient to make the new agreement enforceable. But the traditional preexisting duty rule barred modification unless both parties agreed to assume an additional obligation which would supply independent or "fresh" consideration for the other party's promise. Modern doctrine has expanded enforcement to situations in which there is no fresh consideration. The question you should consider is: "Why?"

Examine closely the court's reasoning in *Alaska Packers*. Try to understand the line modern doctrine draws between enforceable and unenforceable modifications. Finally, consider whether these rules can be defended as implementing the hypothetical bargain that parties themselves would specify ex ante.

The distinction we draw in analyzing modification focuses on the possibility that contract doctrine could allow parties to make a useful precommitment. You should consider whether a similar argument might apply to any other contract rules that we have studied or will study.

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### **3. Rules Concerning Information**

Recall that contractual liability is consensual. We have seen that courts sometimes refuse to enforce agreements because the contracting process deprived one party of the opportunity to understand the nature of the contractual obligations that party has assumed. However, courts invoke unconscionability doctrine only rarely because another group of legal rules regulates access to information more directly. In this section, we examine these rules. After a brief introduction to fraud and misrepresentation doctrine, we focus our attention on the subtle problems that arise in cases of non-disclosure and concealment.

#### **3.1 Fraud and Affirmative Misrepresentation**

The principal goal of misrepresentation doctrine is to deter people from providing false information. Suppose, for example, that Kathy has offered to sell her BMW Z3 roadster to Josh for \$15,000. During a test drive, Josh notices that hard acceleration produces small puffs of white smoke from the car's exhaust. He asks Kathy about the smoke and she responds: "Yes, it's always done that. About six months ago, I took it to the dealer and their shop tested the engine thoroughly. The mechanic said it's just a harmless puff of water vapor from the turbocharger." It turns out, however, that Kathy has never asked the dealer to check this problem. Instead, she used Adobe Photoshop to prepare a fake invoice from the car dealer reporting that the engine is in perfect condition. She hopes that her false statement and the invoice will cause Josh to ignore the smoke and purchase her car.

This hypothetical scenario illustrates how an affirmative misrepresentation can undermine the contracting process. Kathy has invested time and energy in producing a false impression about the condition of her car. There is a real danger that her efforts will mislead Josh and distort his choice among used vehicles. Courts would call Kathy's knowingly false representation "fraudulent" because she knew that what she said was untrue and she intended for it to induce Josh to assent to a contract. A fraudulent misrepresentation of this sort typically will allow its recipient to seek rescission of the resulting contract. *See* Restatement (Second) of Contracts § 164(1). Thus, Josh would have the option to void his obligation to purchase the car or he could elect to go through with the deal.

The most practically significant limitation on a party's right to rescind for a fraudulent misrepresentation is the requirement that the misrepresentation actually induced assent to the contract. Imagine now that Josh only asked Kathy about the wisps of smoke after he had already signed a bill of sale and paid for the car. The parties formed a contract when Josh assented to the sale. Kathy's subsequent misrepresentations thus could not have induced his agreement. On this variation of the facts, Josh would be bound by the contract and unable to rescind the deal unless problems with the car violated an express or implied warranty.

Another important doctrinal limitation on the right of rescission arises from the requirement that the recipient of a misrepresentation be justified in relying. Courts occasionally find that even a fraudulent misrepresentation does not warrant rescission because the recipient should have known that the statement was false. Suppose, for example, that Josh is a certified master mechanic and he knows that the BMW Z3 in question doesn't have a turbocharger nor can a turbocharger emit water vapor. In these circumstances, a court might condemn Kathy's untruthfulness but hold that Josh was not justified in relying on her obviously false statements.

This limitation applies even more frequently to cases involving negligent misrepresentations. As with knowingly false representations, a negligent misrepresentation that induces assent will ordinarily warrant rescission. However, if Kathy was merely careless in reassuring Josh about the condition of her car and Josh had good reason to doubt the accuracy of her statement, then courts tend to weigh the parties' relative degree of fault. Decisions often impose the loss on the party who was most negligent.

Finally, courts find even greater doctrinal flexibility when the representation arguably expresses an opinion rather than asserting facts. Suppose that Kathy simply tells Josh that her car is in “great shape.” Sometimes courts will interpret such statements as mere puffery without legal significance. In other situations, however, decisions have emphasized a special relationship of trust and confidence between the parties or focused on the expertise of the party making the representation. Thus, if Kathy is the master mechanic and Josh a naïve consumer, some courts may be willing to find in Kathy’s statement an implied assertion that she is unaware of any present mechanical problems with the car. If, in fact, she knew at the time that the clutch was failing, her false statement could justify an action for rescission.

There are a number of Restatement sections (referenced below) that address the problem of misrepresentations. As you read these sections, notice also how they incorporate rules for cases of concealment and non-disclosure. Focus on the subtle issues that arise when one party fails to disclose information that would surely affect the other party’s decision about contracting.

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Please read sections 160-62, 164, and 167-69 of the RESTATEMENT (SECOND) OF CONTRACTS.

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### **3.2 Non-Disclosure and Concealment**

Now we turn our attention to several real estate cases involving a failure to disclose material information about the subject matter of the contract. As you read these cases, try to discern the traditional common law rule governing information disclosure in the sale of real estate. Think carefully about how courts have adjusted the traditional rule and whether you think that the benefits of those changes outweigh their costs.

### **3.3 *Reed v. King***

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Please read *Reed v. King* in your volume of Principal Cases.

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### 3.4 *Stambovsky v. Ackley*

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Please read *Stambovsky v. Ackley* in your volume of Principal Cases.

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*Questions for discussion of Reed and Stambovsky:*

What is the traditional common law rule governing the disclosure of information in connection with real estate sales?

How have the California courts sought to protect buyers?

Compare the *Stambovsky* court's statement of New York law. Can you specify precisely under what circumstances New York sellers of real estate have a duty to disclose information to prospective buyers?

Is there any reason to believe that the rules announced in *Reed* and *Stambovsky* might increase the costs associated with real estate transactions?

For an amusing take on *Reed v. King*, view THE SIMPSONS, episode #909, "Reality Bites."

#### 3.4.1 Kronman's Theory of Deliberately Acquired Information

Before we examine several more real estate cases, it will be helpful to think more systematically about how disclosure obligations are likely to affect parties' incentives to obtain and use information. One of the most frequently cited approaches to this problem is Professor Anthony Kronman's theory distinguishing deliberately and casually acquired information.

The centerpiece of Kronman's article is his discussion of a US Supreme Court decision concerning non-disclosure. In *Laidlaw v. Organ*, 15 U.S. (2 Wheat.) 178 (1817), the Court confronted a case in which two parties had been negotiating the purchase and sale of a large quantity of tobacco. On the morning of the sale, news was publicly announced in a handbill that the War of 1812 had ended, thus reopening the foreign tobacco market and increasing by 30 to 50 percent the price of US tobacco. Organ, the buyer, somehow learned this news before he went to close the

deal, but Girault, the seller, was unaware of the change in market conditions. Girault even asked Organ whether he had heard any news that might affect the price of tobacco. Organ evidently declined to answer this question, and Girault decided to go ahead with the contract anyhow. The Court ruled without much analysis or explanation that Organ had no legal duty to inform Girault of such a change in “extrinsic circumstances” but also held that whether Organ had affirmatively misrepresented any facts was a jury question. The following excerpt describes Kronman’s analysis in greater detail:

One effective way of insuring that an individual will benefit from the possession of information (or anything else for that matter) is to assign him a property right in the information itself — a right or entitlement to invoke the coercive machinery of the state in order to exclude others from its use and enjoyment. The benefits of possession become secure only when the state transforms the possessor of information into an owner by investing him with a legally enforceable property right of some sort or other. The assignment of property rights in information is a familiar feature of our legal system. The legal protection accorded patented inventions and certain trade secrets rights are two obvious examples.

One (seldom noticed) way in which the legal system can establish property rights in information is by permitting an informed party to enter — and enforce — contracts which his information suggests are profitable, without disclosing the information to the other party. Imposing a duty to disclose upon the knowledgeable party deprives him of a private advantage which the information would otherwise afford. A duty to disclose is tantamount to a requirement that the benefit of the information be publicly shared and is thus antithetical to the notion of a property right which — whatever else it may entail — always requires the legal protection of private appropriation.

Of course, different sorts of property rights may be better suited for protecting possessory interests in different sorts of information. It is unlikely, for example, that information of the kind involved in *Laidlaw v. Organ* could be effectively protected by a patent system. The only feasible way of assigning property rights in short-lived market

information is to permit those with such information to contract freely without disclosing what they know.

It is unclear, from the report of the case, whether the buyer in *Laidlaw* casually acquired his information or made a deliberate investment in seeking it out (for example, by cultivating a network of valuable commercial “friendships”). If we assume the buyer casually acquired his knowledge of the treaty, requiring him to disclose the information to his seller (that is, denying him a property right in the information) will have no significant effect on his future behavior. Since one who casually acquires information makes no investment in its acquisition, subjecting him to a duty to disclose is not likely to reduce the amount of socially useful information which he actually generates. Of course, if the buyer in *Laidlaw* acquired his knowledge of the treaty as the result of a deliberate and costly search, a disclosure requirement will deprive him of any private benefit which he might otherwise realize from possession of the information and should discourage him from making similar investments in the future.

In addition, since it would enable the seller to appropriate the buyer’s information without cost and would eliminate the danger of his being lured unwittingly into a losing contract by one possessing superior knowledge, a disclosure requirement will also reduce the seller’s incentive to search. Denying the buyer a property right in deliberately acquired information will therefore discourage both buyers and sellers from investing in the development of expertise and in the actual search for information. The assignment of such a right will not only protect the investment of the party possessing the special knowledge, it will also impose an opportunity cost on the other party and thus give him an incentive to undertake a (cost-justified) search of his own.

If we assume that courts can easily discriminate between those who have acquired information casually and those who have acquired it deliberately, plausible economic considerations might well justify imposing a duty to disclose on a case-by-case basis (imposing it where the information has been casually acquired, refusing to impose it where the information is the fruit of a deliberate search). A party who

has casually acquired information is, at the time of the transaction, likely to be a better (cheaper) mistake-preventer than the mistaken party with whom he deals — regardless of the fact that both parties initially had equal access to the information in question. One who has deliberately acquired information is also in a position to prevent the other party's error. But in determining the cost to the knowledgeable party of preventing the mistake (by disclosure), we must include whatever investment he has made in acquiring the information in the first place. This investment will represent a loss to him if the other party can avoid the contract on the grounds that the party with the information owes him a duty of disclosure.

If we take this cost into account, it is no longer clear that the party with knowledge is the cheaper mistake-preventer when his knowledge has been deliberately acquired. Indeed, the opposite conclusion seems more plausible. In this case, therefore, a rule permitting nondisclosure (which has the effect of imposing the risk of a mistake on the mistaken party) corresponds to the arrangement the parties themselves would have been likely to adopt if they had negotiated an explicit allocation of the risk at the time they entered the contract. The parties to a contract are always free to allocate this particular risk by including an appropriate disclaimer in the terms of their agreement. Where they have failed to do so, however, the object of the law of contracts should be (as it is elsewhere) to reduce transaction costs by providing a legal rule which approximates the arrangement the parties would have chosen for themselves if they had deliberately addressed the problem. This consideration, coupled with the reduction in the production of socially useful information which is likely to follow from subjecting him to a disclosure requirement, suggests that allocative efficiency is best served by permitting one who possesses deliberately acquired information to enter and enforce favorable bargains without disclosing what he knows.

A rule which calls for case-by-case application of a disclosure requirement is likely, however, to involve factual issues that will be difficult (and expensive) to resolve. *Laidlaw* itself illustrates this point

nically. On the facts of the case, as we have them, it is impossible to determine whether the buyer actually made a deliberate investment in acquiring information regarding the treaty. The cost of administering a disclosure requirement on a case-by-case basis is likely to be substantial.

As an alternative, one might uniformly apply a blanket rule (of disclosure or nondisclosure) across each class of cases involving the same sort of information (for example, information about market conditions or about defects in property held for sale). In determining the appropriate blanket rule for a particular class of cases, it would first be necessary to decide whether the kind of information involved is (on the whole) more likely to be generated by chance or by deliberate searching. The greater the likelihood that such information will be deliberately produced rather than casually discovered, the more plausible the assumption becomes that a blanket rule permitting nondisclosure will have benefits that outweigh its costs.

In *Laidlaw*, for example, the information involved concerned changing market conditions. The results in that case may be justified (from the more general perspective just described) on the grounds that information regarding the state of the market is typically (although not in every case) the product of a deliberate search. The large number of individuals who are actually engaged in the production of such information lends some empirical support to this proposition.

Anthony Kronman, *Mistake, Disclosure, Information, and the Law of Contracts*, 7 J. LEGAL STUD. (1978).

What does Kronman's analysis imply about situations in which someone responds untruthfully to a question or takes other measures to conceal deliberately acquired information? In a footnote, Kronman appears to suggest that such a variation on the facts of *Laidlaw* would dictate an opposite result:

If Organ denied that he had heard any news of this sort [the treaty], he would have committed a fraud. It may even be, in light of *Laidlaw*'s direct question, that silence on Organ's part was fraudulent. . . . In my

discussion of the case, . . . I have put aside any question of fraud on Organ's part.

*Id.* at note 27.

You should bear Kronman's approach in mind as you read the remaining cases on non-disclosure and concealment.

### **3.5 *Obde v. Schlemeyer***

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Please read *Obde v. Schlemeyer* in your volume of Principal Cases.

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*Questions for discussion:*

In *Obde*, who has the comparative advantage in avoiding this mistake about the existence of termites?

What sort of investments would buyers need to make if they could not rescind a contract in cases of concealment?

### **3.6 *L & N Grove, Inc. v. Chapman***

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Please read *L & N Grove, Inc. v. Chapman* in your volume of Principal Cases.

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*Questions for discussion:*

How would you defend Curtis?

What facts about the interaction between Curtis and Chapman make Chapman's claim for rescission legally implausible?

### 3.6.1 Hypo of Ivy Diamonds

Suppose that an international diamond conglomerate uses satellite imaging to do a geological survey of some farmland that I own near my home in Ivy, Virginia. The survey shows that there is a high likelihood (about 90%) that diamonds (really big ones) lie under the farmland.

What, if anything, should the diamond conglomerate have to disclose to me before they purchase the land?

Suppose that the company also wishes to purchase similar farmland from my neighbor, an 85-year-old blind grandmother. Would you expect courts to treat these two transactions in the same way?

*Questions for further discussion of L&N Grove:*

Suppose that Curtis tries subtly to conceal the purpose for which he is buying the land from Chapman (e.g., he talks about his interest in raising oranges, or he buys under the name of “L&N Grove”). How would you expect a court to react to this conduct?

What if Chapman (and every other seller of property) asks the buyer: “Do you know anything about my property that could affect its value?” What can the buyer say in response?

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View the screencast videos on Non-Disclosure and Concealment: [Part One](#) and [Part Two](#).

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## **Preparing for Class – Non-Disclosure and Concealment**

An essential foundation for mutual assent to contractual obligations is the information parties use to make decisions. The comparatively straightforward misrepresentation doctrine addresses false statements, distinguishing knowing from

negligent or innocent misrepresentations. Far more subtle questions arise under the rules governing non-disclosure and concealment.

Analyze the concealment in *Obde v. Schlemeyer* as a warm-up for tackling the complex non-disclosure issues raised in *L&N Grove v. Chapman* and the Ivy Diamonds hypo.

It may take some time to absorb all of the nuances of these issues. I encourage you to review these materials several times, discuss them among yourselves, and don't hesitate to ask questions in class about any remaining confusion.

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#### **4. The Statute of Frauds**

The Statute of Frauds was originally enacted by Parliament in 1677 under the title “An Act for Prevention of Frauds and Perjuries.” Section four provided:

And be it further enacted by the authority aforesaid, That from and after, the said four and twentieth day of June no action shall be brought (1) whereby to charge any executor or administrator upon any special promise, to answer damages out of his own estate, (2) or whereby to charge the defendant upon any special promise to answer for the debt, default or miscarriages of another person; (3) or to charge any person upon any agreement made upon consideration of marriage; (4) or upon any contract for sale of lands, tenements, or hereditaments, or any interest in or concerning them; (5) or upon any agreement that is not to be performed within the space of one year from the making thereof; (6) unless the agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing, and signed by the party to be charged therewith, or some other person thereunto by him lawfully authorized.

Section seventeen provided:



And be it further enacted by the authority aforesaid, That from and after the said four and twentieth day of June no contract for the sale of any goods, wares and merchandizes, for the price of ten pounds sterling or upwards, shall be allowed to be good, except the buyer shall accept part of the good so sold, and actually receive the same, or give something in earnest to bind the bargain, or in part payment, or that some note or memorandum in writing of the said bargain be made and signed by the parties to be charged by such contract, or their agents thereto lawfully authorized.

The legislatures of most U.S. states have enacted legislation that roughly duplicates the provisions of section four of the original Statute of Frauds. Similarly, UCC § 2-201 establishes a writing requirement for the sale of goods that parallels section seventeen. There has been some scholarly debate about the precise historical circumstances that gave rise to the original statute. However, most contemporary commentary condemns the Statute's writing requirement as a trap for the unwary. Critics argue that this rule gives parties a technical defense to oral promises that they have come to regret. A smaller group of defenders argue that the Statute sensibly encourages parties to make some written memorandum of their deal. On this view, the writing requirement provides far more reliable evidence of the contract and prevents unscrupulous parties from using perjured testimony to obtain fraudulent enforcement of an invented oral promise.

For our present purposes, we will focus on the version of the Statute embodied in the contemporary Uniform Commercial Code.

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Please read UCC § 2-201 and the official comments accompanying that section.

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#### **4.1 *Monetti, S.P.A. v. Anchor Hocking Corp.***

As you read the following case, ask yourself whether Judge Posner could have decided the case on narrower grounds. Consider also whether you agree with his resolution of the many fascinating legal questions that his opinion addresses.

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Please read *Monetti, S.P.A. v. Anchor Hocking Corp.*  
in your volume of Principal Cases.

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#### 4.1.1 Applying the UCC or Common Law Statute of Frauds

Judge Posner discusses at some length the issue of whether UCC § 2-201 or the common law statute of frauds should apply to the transaction in *Monetti*. These boundary wars between different legal regimes occur in other transactional settings as well. As we have seen for some other issues like indefiniteness doctrine, U.S. jurisdictions sometimes adopt conflicting solutions to these problems.

Consider, for example, a contract to install a swimming pool. In Kentucky, the UCC applies because a contract to install a swimming pool “is primarily one [for the sale] of goods and the services are necessary to insure that those goods are merchantable...” *Riffe v. Black*, 548 S.W.2d 175, 177 (Ky. App. 1977). In contrast, Connecticut treats the same transaction as a contract for services governed by the common law. *Gulosh v. Stylarama, Inc.*, 364 A.2d 1221 (Conn. 1975). In some other jurisdictions, courts treat the same deal as a mixed contract and apply different rules to different parts of the transaction.

*Questions for discussion of Monetti:*

How could Judge Posner have decided *Monetti* on far narrower grounds?

Consider whether you agree with Posner’s resolution of the many other issues he addresses including:

(1) Whether the trial judge should have refused to admit oral evidence about the memos.

(2) Whether the UCC statute of frauds can be satisfied by a writing that precedes the parties’ agreement.

(3) Whether the UCC's limits on enforcement for partial performance apply to mixed contracts of this sort, including the clever textual argument about the difference between "transactions in goods" and "contracts for the sale of goods," and the distinction between partial delivery and partial payment.

#### **4.1.2 Hypo on the UCC Statute of Frauds**

On September 1, Bob Byar phones Sally Starbuck, the owner of a local microbrewery, to order a special holiday edition of her Starbuck Ale. At the conclusion of their conversation, Bob and Sally agree that Starbuck will produce and deliver 100 cases at a unit price of \$20 per case. On September 7, Starbuck sends Byar the following note:

Starbuck Brewery, LLC

Just a quick note to confirm your September 1<sup>st</sup> order for 50 cases of our holiday edition of Starbuck Ale at a unit cost of \$20 per case to be delivered no later than November 1<sup>st</sup>.

On September 14, Byar discovers that he can obtain a similar holiday product from another local brewery for only \$15 per case. The next day, he responds to Starbuck with the following note:

Sally,

I thought that we had agreed on 75 cases, but never mind because I've decided that I no longer want any at all this year. Hope though that we can do business in the future.

Best,

/s/ Bob Byar

Now imagine that Starbuck has consulted you about her legal options. She wants to know whether she can bring a suit against Byar for breach of contract. Do the writings in this case satisfy the applicable statute of frauds?

Consider also the following hypothetical variations on the quantities described above:

<b>Variation</b>	<b>Oral</b>	<b>Confirm</b>	<b>Rescind</b>
Original	100	50	75
Different Quantity	50	50	75
Denies Agreement	100	50	0

#### **4.1.3 Proposed Amendments to UCC § 2-201**

Many commentators have raised questions about whether the UCC statute of frauds is compatible with modern business methods. The following excerpt describes the commercial norms and practices in the global currency market:

There is an uneasy tension between the technology and business practices of the foreign exchange market on the one hand, and the demands of contract enforceability rules in sales law on the other hand. The technology is telephonic. It expands the ways in which market participants negotiate and execute currency trades. Communications between [currency traders] are not face-to-face meetings in which written draft contracts are exchanged and marked up by lawyers representing the parties during endless rounds of coffee and take-out sandwiches. The trading floors of [currency traders] are entirely different from the conventional lawyers' conference room; traders often communicate by telephone. In sum, the deals made in the currency bazaar are oral and are concluded rapidly and informally.

The statute of frauds must adapt to this telephonic technology. . . . Foreign exchange market participants might not reduce their agreements to writing for good reason. Because bid-ask spreads are thin for trading in liquid currencies, profits are made through a high volume of trading. To maximize profits, market participants seek to conclude as many transactions as cheaply and quickly as possible.

Outdated legal formalities like the statute of frauds requirements lead to higher transaction costs and delay the completion of transactions. Not surprisingly, many market participants prefer tape recordings of conversations among traders instead of written agreements.

The law also must account for the culture of the currency bazaar. Trust among participants in the foreign exchange market is high. Perhaps this aspect of business culture also distinguishes the trading floor from the conference room. The participants repeatedly deal with one another. To engage in fraudulent or deceptive practices is to invite ostracism: a trader's unctuous behavior quickly becomes widely known and other traders decide it is risky and imprudent to deal with the rogue trader.

Raj Bhala, *A Pragmatic Strategy for the Scope of Sales Law, the Statute of Frauds, and the Global Currency Bazaar*, 72 DENV. U. L. REV. 1, 27–28 (1994).

Proposed amendments to Article 2 of the UCC include the following revisions to the statute of frauds:

**Proposed § 2-201. Formal Requirements; Statute of Frauds**

(1) A contract for the sale of goods for the price of \$5,000 or more is not enforceable by way of action or defense unless there is some record sufficient to indicate that a contract for sale has been made between the parties and signed by the party against which enforcement is sought or by the party's authorized agent or broker. A record is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this subsection beyond the quantity of goods shown in the record.

(2) Between merchants if within a reasonable time a record in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) against the recipient unless notice of objection to its contents is given in a record within 10 days after it is received.

(3) A contract that does not satisfy the requirements of subsection (1) but which is valid in other respects is enforceable:

(a) if the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller's business and the seller, before notice of repudiation is received and under circumstances which reasonably indicate that the goods are for the buyer, has made either a substantial beginning of their manufacture or commitments for their procurement; or

(b) if the party against whom enforcement is sought admits in his pleading, or in the party's testimony or otherwise in court that a contract for sale was made, but the contract is not enforceable under this provision beyond the quantity of goods admitted; or

(c) with respect to goods for which payment has been made and accepted or which have been received and accepted (Sec. 2-606).

(4) A contract that is enforceable under this section is not unenforceable merely because it is not capable of being performed within one year or any other period after its making.

Uniform Commercial Code § 2-103(1)(m) defines a “record” in the following terms:

(m) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

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View the screencast video on the Statute of Frauds.

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## **Preparing for Class – Statute of Frauds**

The venerable Statute of Frauds (born in 1677) imposes a writing requirement for certain categories of contracts. This section is intended to expose you to the basic structure of the Statute of Frauds and to give you some practice applying the UCC version of this writing requirement. Think carefully about how the UCC Statute of Frauds applies to the Starbuck Brewery Hypo.

In practice, one step in your process of evaluating contract disputes should always be to determine whether the relevant Statute of Frauds requires a writing for this type of contract and, if so, whether there is a writing signed by the party against whom enforcement is being sought that satisfies the applicable general or UCC Statute of Frauds. Although you may not need to mention it in your answer, it's always a good idea to think at least briefly about whether the parties in an exam fact pattern have created a sufficient written memorial of their contract.

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## **VI. IDENTIFYING AND INTERPRETING THE TERMS OF AN AGREEMENT**

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

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

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

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

## 1. The Common Law Parol Evidence Rule

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

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

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

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

## 1.1 *Mitchill v. Lath*

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Please read *Mitchill v. Lath* in your volume of Principal Cases.

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## 1.2 *Masterson v. Sine*

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Please read *Masterson v. Sine* in your volume of Principal Cases.

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*Questions for discussion of Mitchill and Masterson:*

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

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

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

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

### 1.2.1 The Use of Merger Clauses

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

This Agreement represents the Parties' entire understanding regarding the subject matter herein. None of the terms of this Agreement can be

waived or modified, except by an express agreement signed by the Parties. There are no representations, promises, warranties, covenants, or undertakings between the Parties other than those expressly set forth in this Agreement.

OR

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

OR

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

OR

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

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

### **1.2.2 The Restatement Formulation of the Parol Evidence Rule**

It should be apparent from reading *Mitchill v. Lath* and *Masterson v. Sine* that there is no consensus among judges or jurisdictions about when to consider evidence of prior or contemporaneous oral agreements. Nevertheless, there is broad agreement about the general doctrinal framework within which these issues are analyzed. Whether textualist or contextualist, jurists all ask first whether the written agreement is partially or completely “integrated” and then whether the proffered additional terms are “consistent” with the writing. The Restatement (Second) of Contracts formulates these rules in a series of sections beginning with § 209.

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Please read sections 209-10 and 213-16 of the RESTATEMENT (SECOND) OF  
CONTRACTS.

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## **2. The UCC Parol Evidence Rule**

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

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Please read UCC § 2-202 and the official comments accompanying that section.

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

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

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

(1) the agreement of the parties with respect to the transaction involves repeated occasions for performance by a party; and

(2) the other party, with knowledge of the nature of the performance and opportunity for objection to it, accepts the performance or acquiesces in it without objection.

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

(c) A "usage of trade" is any practice or method of dealing having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage must be proved as facts. If it is established that such a usage is embodied in a trade code or similar record, the interpretation of the record is a question of law.

(d) A course of performance or course of dealing between the parties or usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware is relevant in ascertaining the

meaning of the parties' agreement, may give particular meaning to specific terms of the agreement, and may supplement or qualify the terms of the agreement. A usage of trade applicable in the place in which part of the performance under the agreement is to occur may be so utilized as to that part of the performance.

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

(1) express terms prevail over course of performance, course of dealing, and usage of trade;

(2) course of performance prevails over course of dealing and usage of trade; and

(3) course of dealing prevails over usage of trade.

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

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

Va. Code § 8.1A-303.

## **2.1 *Hunt Foods & Industries v. Doliner***

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

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Please read *Hunt Foods & Industries v. Doliner* in your volume of Principal Cases.

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### 2.1.1 Note on *Snyder v. Herbert Greenbaum & Assoc.*

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

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

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

At any rate, for much the same reason, we hold that the additional terms offered by appellants are inconsistent with the contract itself. In so doing we reject the narrow view of inconsistency espoused in *Hunt Foods v. Doliner*, 26 A.D.2d 41, 270 N.Y.S.2d 937 (1966), and *Schiavone and Sons v. Securalloy Co.*, 312 F. Supp. 801 (D. Conn. 1970). Those cases hold that to be inconsistent the “additional terms” must negate or contradict express terms of the agreement.

This interpretation of “inconsistent” is itself inconsistent with a reading of the whole of § 2-202. Direct contradiction of express terms is forbidden in the initial paragraph of § 2-202. The *Hunt Foods*



interpretation renders that passage a nullity, a result which is to be avoided. *Gillespie v. R & J Constr. Co.*, 275 Md. 454 (1975).

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

*Id.* at 152.

*Questions for discussion of Hunt Foods:*

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

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

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

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

### **3. Interpretation**

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

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

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

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View the screencast videos on the Parol Evidence Rule: [Part One](#) and [Part Two](#).

View the screencast video on [Interpretation](#).

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## **Preparing for Class – Terms & Interpretation**

When parties argue about whether they've performed or not, the dispute often centers on determining what terms have become part of their agreement (or interpreting key contract terms). The Parol Evidence Rule addresses the first of these questions using the dual filters of integration and consistency to determine which prior or contemporaneous terms to incorporate into the contract. As you will discover, these doctrines require courts to make a fundamental choice between the text of the written contract and the proffered contextual evidence.

You will benefit from repeated exposure to these complicated rules. I'd encourage you to review the Parol Evidence Rule materials several times to help resolve any lingering confusion and to fix the ideas in your mind.

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## **VII. REMEDIES FOR BREACH**

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

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

### **1. Monetary Damages**

#### **1.1 Introduction**

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

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Please read sections 344, 346-47, and 350-53 of the RESTATEMENT (SECOND) OF CONTRACTS.

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

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Please read UCC §§ 2-711, 2-712, 2-713, and 2-715.

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### **1.1.1 Note on *Globe Refining Co. v. Landa Cotton Oil Co.***

In *Globe Refining Co. v. Landa Cotton Oil Co.*, 190 U.S. 540 (1903), a Texas supplier made a contract to deliver ten railroad tanker cars of prime crude oil “f.o.b. buyers’ tanks at [sellers’] mill.” When the sellers repudiated the deal shortly before the time for delivery, the Kentucky buyers sued, seeking compensation for the cost of sending their tanker cars to Texas. They also sought to recover for the loss of use of the cars and for damages suffered when the lack of oil forced the buyers to breach contracts with their own customers. Justice Oliver Wendell Holmes affirmed the trial court’s ruling that the proper damage measure in this case was “the difference between the contract price of the oil and the price at the time of the breach.” He explained the underlying principles of contract damages in the following terms:

When a man commits a tort, he incurs, by force of the law, a liability to damages, measured by certain rules. When a man makes a contract, he incurs, by force of the law, a liability to damages, unless a certain promised event comes to pass. But, unlike the case of torts, as the contract is by mutual consent, the parties themselves, expressly or by implication, fix the rule by which the damages are to be measured. The old law seems to have regarded it as technically in the election of the promisor to perform or to pay damages. *Bromage v. Genning*, 1 Rolle, 368; *Hulbert v. Hart*, 1 Vern. 133. It is true that, as people when contracting contemplate performance, not breach, they commonly say

little or nothing as to what shall happen in the latter event, and the common rules have been worked out by common sense, which has established what the parties probably would have said if they had spoken about the matter. But a man never can be absolutely certain of performing any contract when the time of performance arrives, and, in many cases, he obviously is taking the risk of an event which is wholly, or to an appreciable extent, beyond his control. The extent of liability in such cases is likely to be within his contemplation, and, whether it is or not, should be worked out on terms which it fairly may be presumed he would have assented to if they had been presented to his mind. For instance, in the present case, the defendant's mill and all its oil might have been burned before the time came for delivery. Such a misfortune would not have been an excuse, although probably it would have prevented performance of the contract. If a contract is broken, the measure of damages generally is the same, whatever the cause of the breach. We have to consider, therefore, what the plaintiff would have been entitled to recover in that case, and that depends on what liability the defendant fairly may be supposed to have assumed consciously, or to have warranted the plaintiff reasonably to suppose that it assumed, when the contract was made.

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

made with regard to the claim for loss of use of the tanks and to the final allegations as to sending the tanks from distant points. It is true that this last was alleged to have been in contemplation of the contract, if we give the plaintiff the benefit of the doubt in construing a somewhat confused sentence. But, having the contract before us, we can see that this ambiguous expression cannot be taken to mean more than notice, and notice of a fact which would depend upon the accidents of the future.

It is to be said further with regard to the foregoing items that they were the expenses which the plaintiff was willing to incur for performance. If it had received the oil, these were deductions from any profit which the plaintiff would have made. But if it gets the difference between the contract price and the market price, it gets what represents the value of the oil in its hands, and to allow these items in addition would be making the defendant pay twice for the same thing.

### **1.1.2 Hypo Based on *Globe Refining***

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

Plaintiff contracts to buy 10 tanker trucks full of fuel oil at \$10,000 per truckload. The defendant seller is in Louisville, Kentucky, and plaintiff buyer is in New Braunfels, Texas. The buyer sends a \$4,000 deposit check. On the agreed delivery date, the buyer sends ten empty tank trucks from Texas to Louisville at a total cost of \$1,600. But the seller has already sold the oil to a New York buyer for \$14,000 per truckload.

Oil is available in Indianapolis for \$12,000 per truckload but it is not available in Louisville. Plaintiff buyer could send trucks to Indianapolis for a total cost of \$700. But instead he sends them back to Texas empty. As a result, plaintiff breaches several contracts with customers in Texas. These breaches cost \$54,000. Some customers announce that they will no longer do business with plaintiff. Finally,



the plaintiff suffers a serious nervous breakdown and pays \$1,000 for treatment. Plaintiff sues in Texas state court. His attorney's fees are \$20,000. It takes two years for the case to come to trial.

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

*Questions for discussion of hypo based on Globe Refining:*

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

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

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

## **1.2 *Freund v. Washington Square Press***

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

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Please read *Freund v. Washington Square Press* in your volume of Principal Cases.

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*Questions for discussion:*

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

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

Why does Freund receive no recovery of royalties?

Does this rule strike you as fair?

### **1.3 The “Coase Theorem” and Efficient Breach**

In this section we will examine the theory of “efficient breach” and determine what it has to teach us about designing contract damage rules.

#### **1.3.1 The Theory of Efficient Breach**

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

It makes a difference in deciding which remedy to grant whether the breach was opportunistic. If a promisor breaks his promise merely to take advantage of the vulnerability of the promisee in a setting (the normal contract setting) when performance is sequential rather than simultaneous, we might as well throw the book at the promisor....

Most breaches of contract, however, are not opportunistic. Many are involuntary; performance is impossible at a reasonable cost. Others are voluntary but (as we are about to see) efficient—which from an economic standpoint is the same case as that of an involuntary breach. These observations both explain the centrality of remedies to the law of contracts (can you see why?) and give point to Holmes’s dictum that it is not the policy of the law to compel adherence to contracts but only to require each party to choose between performing in accordance

with the contract and compensating the other party for any injury resulting from a failure to perform.<sup>1</sup>

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

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

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<sup>1</sup> [Posner here cites] Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897) [which reads:

Nowhere is the confusion between legal and moral ideas more manifest than in the law of contract. Among other things, here again the so called primary rights and duties are invested with a mystic significance beyond what can be assigned and explained. The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it – and nothing else. If you commit a tort, you are liable to pay a compensatory sum. If you commit a contract, you are liable to pay a compensatory sum unless the promised event comes to pass, and that is all the difference. But such a mode of looking at the matter stinks in the nostrils of those who think it advantageous to get as much ethics into law as they can.]

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

RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* (2007)

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

*Questions for discussion of efficient breach:*

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

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

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

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

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

### **1.3.2 The Coase Theorem**

In order to fully understand efficient breach theory, it will also be helpful to learn about an economic theory known as the “Coase Theorem.” Although we will explore alternative formulations, proponents of the Coase Theorem typically assert that if parties stand to gain by rearranging their legal rights and if they are free to negotiate about those rights, then they will agree to an efficient reallocation of their legal entitlements. The idea is that parties know what’s good for them and will capture any available gains from trade. According to the theory, legal rights are no different than buying and selling cars or houses. If you have a right that your neighbor values more than you do, then it makes sense that your neighbor will offer and you will accept a suitable payment in exchange for that right.

A frequently used aphorism—“The rule doesn’t matter”—expresses a striking consequence of this formulation of the Coase Theorem. If parties always reallocate their legal rights in an efficient way, then the initial allocation of legal rights (e.g., the right to be free from nuisances such as noise or pollution, the right to be excused from performance for supervening commercial impracticability, or the right to recover expectation damages for the breach of a contract) will not affect parties’ behavior or prevent them from achieving an efficient allocation of resources. A more formal term for the idea that “the rule doesn’t matter” is thus “Coasean invariance”—that is, party behavior is invariant to the initial allocation of legal rights.

We will soon analyze a hypothetical that illustrates the application of this principle and also discover the remarkably strong assumptions that are necessary to produce this result. Indeed, the principal goal of Ronald Coase’s justly famous article *The Problem of Social Cost*, 3 JOURNAL OF LAW & ECONOMICS 1 (1960), was to

examine those assumptions, which are only very rarely fully satisfied in the real world. It is therefore oddly ironic that Coase's name has become so closely associated with a proposition that he never seriously advanced. *See* Robert C. Ellickson, *The Case for Coase and Against Coaseanism*, 99 YALE L.J. 611 (1989).

### 1.3.3 Hypo of Dan and Lynn on the River

*(inspired by a hypothetical that appeared in an early edition of the SCOTT & LESLIE, CONTRACT LAW & THEORY casebook)*

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

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

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

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

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

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

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

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

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

### 1.3.4 Problem: Signing Bonus for First-Year Associates

Suppose that newly enacted legislation declares the following:

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

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

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

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View the screencast video on [Monetary Damages](#).

View the screencast video on [Efficient Breach and Coase Theorem](#).

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## Preparing for Class – Monetary Damages

In this section we began our study of contract remedies with monetary damages. Focus on applying these damage rules and on understanding the concept of efficient breach and arguments based on the so-called Coase Theorem. Be sure to review these materials carefully because each of our damage topics depends on a thorough understanding of the fundamental principles discussed in this section.

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## 2. Specific Performance

As we saw in *Lucy v. Zehmer*, one way to ensure that the promisee (Lucy) receives precisely what he wanted from the contract is to order the promisors

(the Zehmers) to perform by conveying title to the Ferguson farm. Although courts routinely order “specific performance” of real estate sales contracts, they also grant specific performance in appropriate circumstances to remedy the breach of a contract for the sale of goods.

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

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Please read UCC § 2-716.

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

### **2.1 *Klein v. Pepsico***

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

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Please read *Klein v. Pepsico* in your volume of Principal Cases.

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#### *Questions for discussion:*

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

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



## **2.2 *Sedmak v. Charlie's Chevrolet, Inc.***

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

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Please read *Sedmak v. Charlie's Chevrolet, Inc.* in your volume of Principal Cases.

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### **2.2.1 The UCC and Restatement on Specific Performance**

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

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Please read sections 357 and 359-60 of the RESTATEMENT (SECOND) OF CONTRACTS.

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We have already seen the relevant UCC provision on specific performance in connection with our study of *Klein v. Pepsico*, but you should compare that section to the Restatement's discussion of specific performance.

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Please read UCC § 2-716 and the official comments accompanying that section.

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### **2.2.2 The Meaning of “Other Proper Circumstances”**

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

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

*Id.* at 553.

### **2.2.3 Monetary Specific Performance**

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

Because monetary specific performance may give the buyer an amount far greater than any plausible estimate of the market-contract price differential, courts are often reluctant to exercise this power. In *Bander v. Grossman*, 611 N.Y.S.2d 985 (1994), for example, a dealer in collectible cars failed to deliver a rare Aston Martin because he was unable to clear the title to the vehicle. Prices of collectible automobiles are remarkably volatile, and the price of this Aston Martin fluctuated wildly during the period from contract formation to final judgment.

<b>TIME</b>	<b>PRICE</b>
Contract Price (Summer 1987)	\$40,000
Time of Breach (December 1987)	\$60,000
Sale to Third Party (April 1989?)	\$225,000
Peak Price in (July 1989)	\$335,000
Time of Trial (1993?)	\$80,000

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

With the passage of time, specific performance becomes disfavored. For example, because goods are subject to a rapid change in condition, or the cost of maintenance of the goods is important, time may be found to have been of the essence, and even a month's delay may defeat specific performance....

Turning to the facts of the instant case, the plaintiff did not sue in December of 1987, when it is likely a request for specific performance would have been granted. At that point, the defendant had disclaimed the contract and plaintiff was aware of his rights. The plaintiff was not protected by a continued firm assurance that defendant definitely would perfect the car's title.... The court does not accept plaintiff's protest that he believed the commercial relationship was intact; the parties had already had a heated discussion and were communicating

through attorneys. A more likely explanation of plaintiff's inaction is that he proceeded to complete the purchase in April of 1988 of a Ferrari Testarossa for \$128,000 and a Lamborghini for \$40,000 in 1989.

*Id.* at 990.

#### **2.2.4 Note on *American Brands v. Playgirl***

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

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

*American Brands* is clearly distinguishable from this case. PC Brand is a much smaller company than American Brands, Inc., a tobacco company, and its target market is more limited. PC Brand is a mail order computer company, whose only clients come from its magazine advertisements, which include mail and telephone order forms. In contrast, American Brands, Inc.'s advertising targets are much more diverse. Moreover, the tobacco company was not structured around an advertising and discount scheme as was PC Brand, and it would not have suffered irreparable injury nor been put out of business due to the absence of one advertising vehicle.

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

### 2.2.5 Alan Schwartz's *Case for Specific Performance*

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

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

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

Thus the compensation goal supports removing rather than retaining present restrictions on the availability of specific performance.

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

If specific performance is the appropriate remedy in such cases, there are three reasons why it should be routinely available. The first reason is that in many cases damages actually are undercompensatory. Although promisees are entitled to incidental damages, such damages are difficult to monetize. They consist primarily of the costs of finding and making a second deal, which generally involve the expenditure of time rather than cash; attaching a dollar value to such opportunity costs is quite difficult. Breach can also cause frustration and anger,

especially in a consumer context, but these costs also are not recoverable.

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

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

Second, promisees have economic incentives to sue for damages when damages are likely to be fully compensatory. A breaching promisor is reluctant to perform and may be hostile. This makes specific performance an unattractive remedy in cases in which the promisor's performance is complex, because the promisor is more likely to render a defective performance when that performance is coerced, and the defectiveness of complex performances is sometimes difficult to establish in court. Further, when the promisor's performance must be rendered over time, as in construction or requirements contracts, it is costly for the promisee to monitor a reluctant promisor's conduct. If

the damage remedy is compensatory, the promisee would prefer it to incurring these monitoring costs. Finally, given the time necessary to resolve lawsuits, promisees would commonly prefer to make substitute transactions promptly and sue later for damages rather than hold their affairs in suspension while awaiting equitable relief. The very fact that a promisee requests specific performance thus implies that damages are an inadequate remedy.

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

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

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



### 2.2.6 The Goetz & Scott Approach to Breach and Mitigation

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

There may be circumstances ... in which the obligee can more advantageously make all or part of the adjustment. For example, Buyer may be able to install adjustable windows, use temporary air conditioning units, or even delay occupancy until the strike is settled. Seller would be foolish under such circumstances to adjust autonomously; that would not be the cheapest way to satisfy his performance obligation. Seller would instead prefer that Buyer readjust, even though Seller will have to bear the resulting expense. One can characterize an obligor's decision to breach, therefore, as an election to surrender irrevocably his option to perform—a request that the obligee bear all future adjustment costs, with damages provided as reimbursement. Breach is the obligor's signal that: "My assessment of our relative capacities suggests that you enjoy the comparative advantage on all prospective adjustments. Therefore, please undertake all cost-minimizing adjustments and send me the bill." In essence, breach involves a final commitment to quasi-performance (breach with damages) as the most efficient means of satisfying the original contractual obligation.

This approach rests on the general principle that we should design legal rules to reduce the parties' joint costs of contracting. Efficient damage rules must encourage both parties to participate in reducing the costs of breach. When the obligor announces her decision to breach, it becomes a "cry for help" intended to enlist the aid of the obligee in obtaining substitute performance as cheaply as possible. The conventional expectation damage measure joins with the avoidability doctrine to give the obligor an option to breach and pay the obligee's cost of cover rather than continuing with performance regardless of its cost. An award of specific performance, in contrast, gives the obligee an unconditional right to receive the promised

performance from the obligor. If the remedy of specific performance were routinely available, obligees would have far fewer incentives to cooperate.

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

*Questions for discussion of specific performance:*

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

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

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

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

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

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

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

Consider the concluding sentence of the Schwartz excerpt:

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

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

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View the screencast video on [Specific Performance](#).

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## Preparing for Class – Specific Performance

If you want to make sure that a promisee gets what they bargained for, an order of specific performance ought to do the trick. Despite this obviously appealing feature of the remedy, courts limit its availability to very specific circumstances and instead award expectation damages. We'll learn how to identify when specific performance is appropriate and why courts' preference for the expectation damage remedy might be justifiable.

Look closely at the court's reasoning in *Sedmak v. Charlie's Chevrolet* along with the note cases *King Aircraft*, *Bander v. Grossman* and *American Brands v. Playgirl*. In addition, consider carefully the relative merits of expectation damages and specific performance.

The issue of protecting subjective valuation will arise again very shortly when we study the choice between cost of performance and value of performance as a measure of damages. Also try to bear in mind the normative arguments we've considered as you learn more about the foreseeability, certainty and avoidability limitations on damages.

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### 3. Limitations on Damages

In this section, we consider more closely the main doctrinal limitations on monetary damages—foreseeability, certainty and mitigation. Our discussion of the hypo based on *Globe Refining* introduced the idea that courts refuse to compensate a promisee for unforeseeable losses. As we will soon see, the venerable English case of *Hadley v. Baxendale* defines the basic contours of a rule that promisees may recover only for those losses that were reasonably foreseeable at the time of contracting. Recall also that in *Freund v. Washington Square Press*, the certainty limitation prevented Freund from recovering any loss of royalties due to the failure to publish

his book on modern drama. We consider here the related problem of recovering lost profits from a new business and see in *Drews Company v. Ledwith-Wolfe Associates* how the doctrinal requirement of reasonable certainty may cause significant under-compensation. Finally, recall that in the *Globe Refining* hypo, a doctrine of avoidable consequences precluded recovery for damages that the promisee could have taken cost-justified steps to mitigate. See Restatement § 350; UCC § 2-715. In *Rockingham County v. Luten Bridge Co.*, we will see how the repudiation of a contract may present the promisee with surprisingly difficult decisions about mitigation and significant potential risks. Finally, *Parker v. Twentieth Century Fox* shows us how mitigation doctrine applies to one (very lucrative) employment contract and poses the challenging question of whether a promisee should have to accept an offer of substitute performance from the breaching party.

### 3.1 *Hadley v. Baxendale*

The foreseeability doctrine is most often associated with a famous 19<sup>th</sup> century English case.

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Please read *Hadley v. Baxendale* in your volume of Principal Cases.

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#### 3.1.1 The Facts of *Hadley v. Baxendale*

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

In considering the meaning and application of these rules it is essential to bear clearly in mind the facts on which *Hadley v. Baxendale* proceeded. The headnote is definitely misleading insofar as it says that the defendant's clerk, who attended at the office, was told that the mill was stopped and that the shaft must be delivered immediately. The same allegation figures in the statement of facts which are said on page

344 to have “appeared” at the trial before Crompton, J. If the Court of Exchequer had accepted these facts as established, the court must, one would suppose, have decided the case the other way round.... But it is reasonably plain from Alderson B.’s judgment that the court rejected this evidence, for on page 355 he says: “We find that the only circumstances here communicated by the plaintiffs to the defendants at the time when the contract was made were that the article to be carried was the broken shaft of a mill and that the plaintiffs were the millers of the mill.”

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

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

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

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

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

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

*Questions for discussion of Hadley:*

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

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

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

Suppose now that you moved to a jurisdiction in which an anti-*Hadley* default rule of unlimited consequential damages prevailed. How are carriers like Pickford & Co. or UPS likely to adapt to this new default rule?

Danzig asserts that the increasingly complex nature of modern enterprises makes it “self-evidently impossible to serve legally cognizable notice on” an airline that a scheduled flight is of special importance or a phone company that uninterrupted

service is particularly vital. Can you think of any response to this critique of the *Hadley* rule?

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

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View the screencast video on [Foreseeability](#).

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## Preparing for Class – Foreseeability

As we've already seen, both the common law and the UCC limit recovery of damages to those losses that are reasonably foreseeable. This section focuses on one of the most famous contracts cases of all and explores some of the theoretical questions the foreseeability doctrine implicates.

Consider whether the facts of *Hadley v. Baxendale* make the mill's lost profits foreseeable or not. Then try to develop normative arguments concerning the foreseeability limitation. Some will support the restrictive *Hadley* rule, but others will suggest possible social benefits from adopting instead an "anti-*Hadley*" full consequential damages rule.

The foreseeability limitation raises theoretical questions that have fascinated academic commentators and judges for decades. Reflecting on how the rule interacts with real world markets and contract practices will give you a valuable model for developing a deeper understanding of other contract doctrines that you encounter.

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### 3.2 Introduction to the Certainty Limitation

Courts routinely require plaintiffs to prove any loss from a breach of contract with reasonable certainty. Restatement § 352 describes the common law certainty doctrine.

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Please read section 352 of the RESTATEMENT (SECOND) OF CONTRACTS.

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### **3.3 *Drews Company v. Ledwith-Wolfe Associates***

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Please read *Drews Co. v. Ledwith-Wolfe Assoc.* in your volume of Principal Cases.

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#### **3.3.1 Other Applications of the Certainty Limitation**

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

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

Our research fails to reveal any judicial authority in Pennsylvania which sustains, under the Sales Act, a recovery for a loss of good will occasioned either by non-delivery or by the delivery of defective goods. As this Court stated in *Michelin Tire Co. v. Schulz*, 295 Pa. 140, 144: "so far as appears, the tires in question were all used by defendant's customers and paid for, so he lost nothing thereon. What he claims is that, because the tires were less durable than recommended, he lost customers, which otherwise he would have retained and whose business would have netted him a profit.... This is entirely too speculative and not the proper measure of damages." ... We are in agreement with the statement of the Court in *Armstrong Rubber Co. v. Griffith*, 43 F.2d 689, 691 (2d Cir.), that: "If the plaintiff here can recover for loss of good will, it is difficult to see what limits



are to be set to the recovery of such damages in any case where defective goods are sold (or where goods are not delivered) and the vendee loses customers. Indeed, if such were the holding, damages which the parties never contemplated would seem to be involved in every contract of sale.”

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

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

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

*Id.* at 894.

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

*Questions for discussion of the certainty limitation:*

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

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

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

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

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View the screencast video on [Certainty](#).

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### **Preparing for Class – Certainty Limitation**

As we saw when we discussed the difficulty that Freund would have proving lost royalties, the certainty limitation precludes recovery for speculative losses. This section introduces you to some of the most common situations in which this limitation constrains the damages available for breach.

Try to bear in mind the importance of developing a sound evidentiary foundation for your client's damage claims. And recognize that lost profits from a new business as well as losses affecting a business's reputation are the most difficult to recover and require the most effort to establish at trial.

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### 3.4 Introduction to Avoidability and Mitigation

We have encountered several times the so-called “mitigation principle” which implies that damages for breach of contract exclude any loss that the promisee could have reasonably avoided. One important consequence of this rule is that the announcement of a breach of contract requires the promisee to decide how to respond. They may seek substitute performance—a covering transaction—or they may choose to delay covering and take their chances in the evolving market for the originally promised performance. Restatement § 350 describes the common law approach to avoidability and mitigation of damages.

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Please read section 350 of the RESTATEMENT (SECOND) OF CONTRACTS.

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

### 3.5 *Rockingham County v. Luten Bridge Co.*

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Please read *Rockingham Cty. v. Luten Bridge Co.* in your volume of Principal Cases.

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*Questions for discussion:*

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

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

associated with ceasing construction? Does the Luten Bridge Company have any alternatives other than continuing or terminating the project?

### **3.6 *Parker v. Twentieth Century-Fox Film Corp.***

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Please read *Parker v. Twentieth Century-Fox* in your volume of Principal Cases.

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*Questions for discussion:*

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

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

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

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

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View the screencast video on [Avoidability-Mitigation](#).

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## Preparing for Class – Avoidability/Mitigation

Although parties usually opt out of the foreseeability limitation by expressly excluding recovery for consequential damages, litigation about promisees' efforts to mitigate damages is quite common. The tricky questions for parties facing a potential breach are when to begin mitigating and what exactly is required of the non-breaching party.

Use the facts of *Luten Bridge* to explore the question of when to start mitigating. Then analyze how the mitigation obligation applies to employment contracts, both the unusual situation in *Parker v. 20th Century Fox* and more typical employment relationships.

Although you're likely to find the mitigation obligation reasonably intuitive, it is important to keep the principle in mind when you are counseling clients. Clear communication between the parties can reduce uncertainty about whether mitigation is necessary. And recognizing the purpose of the mitigation doctrine will help you to decide whether any particular effort to avoid loss is required.

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### 4. Cost of Completion vs. Difference in Value

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

#### 4.1 *American Standard v. Schectman*

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Please read *American Standard v. Schectman* in your volume of Principal Cases.

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## 4.2 *Peevyhouse v. Garland Coal & Mining Co.*

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Please read *Peevyhouse v. Garland Coal* in your volume of Principal Cases.

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### 4.2.1 The Story of *Peevyhouse*

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

From the Peevyhouses' perspective, obtaining the promised remedial work was essential. Having observed the effects of strip-mining under the standard arrangement, they agreed to forego immediate payment of \$3000 in consideration for Garland's promises of basic reclamation. The leased acreage was part of their homestead estate and connected to the land on which they lived but refused to lease. When placed against this backdrop, it is clear that the Peevyhouses highly valued the future utility of the leased land. These fundamental facts relate to their main purpose, as evidence of the express bargained-for-exchange, with payment of separate valuable consideration for remedial provisions....

Willie and Lucille still live on the land located outside of Stigler. The land they leased to Garland has changed little from when the mining stopped more than thirty-five years ago. About half of the leased acreage remains unusable.

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

Other commentators have expressed similar views about the case:

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

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

#### **4.2.2 Note on *Rock Island Improvement Company v. Sexton***

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

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

#### **4.2.3 The Second Restatement on Cost vs. Value**

Although the Restatement does not speak directly to the situation in *American Standard* and *Peevyhouse*, § 347 provides that the loss in value of performance

caused by a breach is ordinarily the proper measure of the promisee's expectation interest. Section 348 offers "alternatives to loss in value of performance" for specific situations. Most nearly relevant to the issues we have been addressing is the following subsection of § 348:

(2) If a breach results in defective or unfinished construction and the loss in value to the injured party is not proved with sufficient certainty, he may recover damages based on

(a) the diminution in the market price of the property caused by the breach, or

(b) the reasonable cost of completing performance or of remedying the defects if that cost is not clearly disproportionate to the probable loss in value to him.

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

*Questions for discussion of American Standard and Peevyhouse:*

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

The situations presented are artificial ones. It is highly unlikely that the ordinary property owner would agree to pay \$29,000 (or its equivalent) for the construction of "improvements" upon his property that would increase its value only about (\$300) three hundred dollars.

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

Suppose for the sake of discussion that in both *American Standard* and *Peevyhouse* the cost of completing the contractually specified grading work far exceeds its value to the landowner. Can you think of any reason to doubt that ordering



Garland Coal or Schectman to perform or pay damages equal to the cost of performing will cause any economic waste?

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

Now consider the possibility that both cases were wrongly decided.

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

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

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

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View the screencast video on [Cost vs. Value of Performance](#).

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## **Preparing for Class – Cost vs. Value of Performance**

This section focuses narrowly on one problem that arises in deciding how to implement the expectation measure of contract damages. Try to determine what exactly it means to put the promisee in the position she would have been in if the contract had been performed.

The two cases in this section reach essentially opposite results on quite similar facts. First examine the "economic waste" argument on which courts sometimes rely. Then explore the surprising possibility that both *Schectman* and *Peevyhouse* were wrongly decided. Finally, try to develop a deeper theory about what's at stake in the choice between the cost of performance and the value of performance measure of damages.

You should reconsider our earlier discussions of substantial performance and of the expectation measure and be certain that you can integrate what you've learned in this section with what we learned about those earlier topics.

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## 5. Liquidated Damages

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

Restatement § 356 explains the common law approach to liquidated damages.

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Please read section 356 of the RESTATEMENT (SECOND) OF CONTRACTS.

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The parallel provisions of the Uniform Commercial Code are found in § 2-718.

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Please read UCC § 2-718.

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

### **5.1 *Lake River Corp. v. Carborundum Co.***

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Please read *Lake River Corp. v. Carborundum* in your volume of Principal Cases.

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*Questions for discussion:*

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

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

### **5.2 *C&H Sugar Co. v. Sun Ship***

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Please read *C&H Sugar Co. v. Sun Ship* in your volume of Principal Cases.

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### **5.3 Economic Justifications for Liquidated Damages**

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

The parties to a contract are not free to provide a penalty for its breach. The central objective behind the system of contract remedies is compensatory, not punitive. Punishment of a promisor for having broken his promise has no justification on either economic or other

grounds and a term providing such a penalty is unenforceable on grounds of public policy.

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

[C]ontracting parties have incentives to negotiate liquidated damages clauses whenever the costs of negotiating are less than the expected costs resulting from reliance on the standard damage rule for breach. There are two primary factors which might induce the decision to negotiate:

- (1) The expected damages are readily calculable, but the parties determine that advance stipulation will save litigation or settlement costs;
- (2) The expected damages are uncertain or difficult to establish and the parties wish to allocate anticipated risks.

Of course, these factors may be present singly or in combination.

Pre-breach agreements will not be legally enforceable, however, unless two requirements coincide. First, the agreement must be a reasonable forecast of just compensation for the anticipated harm that would be caused by the breach. Second, the possible damages which might result from the breach must be uncertain and difficult to estimate. However, liquidated damages provisions have seldom been voided solely because the damages were easy to estimate. Instead, courts have considered the degree of uncertainty an influential factor in determining the reasonableness of the estimate. If the conditions inducing damage agreements are viewed on a continuum, the application of the penalty rule becomes clearer: as the uncertainty

facing the contracting parties increases, so does their latitude in stipulating post-breach damages.<sup>2</sup>

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

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<sup>2</sup> It appears that the drafters of the Uniform Commercial Code have tacitly adopted this approach. Section 2-718(1) of the U.C.C. allows parties to liquidate damages for breach as long as the amount stipulated is “reasonable.” The reasonableness of a particular amount is determined, in part, by the “difficulties of proof of loss” from the breach. While it might be argued that the U.C.C. rule approximates the common law uncertainty requirement, as does the 1 NEW YORK LAW REVISION COMMISSION, REPORT OF THE LAW REVISION COMMISSION FOR 1955, STATE OF NEW YORK, STUDY OF THE UNIFORM COMMERCIAL CODE 581-82, it appears that a change has been made. The language of U.C.C. § 2-718 itself treats “uncertainty” as merely one factor, and not even a required one, of many to be considered in determining reasonableness.

In addition to uncertainty, courts have also been influenced by the relationship between the stipulated amount and the provable harm actually caused by the breach. Although a number of courts have refused to enforce agreements because of the absence of provable losses upon breach, many cases have held that actual loss is irrelevant except as it permits inferences concerning the reasonableness of the agreements viewed *ex ante*. *Frick Co. v. Rubel Corp.*, 62 F.2d 765, 767-68 (2d Cir. 1933); *In re Lion Overall Co.*, 55 F. Supp. 789 (S.D.N.Y. 1943), *aff'd sub nom, United States V. Walkof*, 144 F.2d 75 (2d Cir. 1944); *Bryon Jackson Co. v. United States*, 35 F. Supp. 665 (S.D. Cal. 1940); *McCarthy v. Tally*, 46 Cal.2d 577, 297 P.2d 981 (1956). *But see Rowe v. Shehyn*, 192 F. Supp. 428 (D.D.C. 1961); *Marshall v. Patzman*, 81 Ariz. 367, 370-71, 306 P.2d 287, 290-91 (1957); *Gorco Constr. Co. v. Stein*, 256 Minn. 476, 481-84, 99 N.W.2d 69, 74-76 (1959). *See generally* Macneil, *supra* note 14, at 504-509; Sweet, *Liquidated Damages in California*, 60 CALIF. L. REV. 84, 131-33 (1972).

compensation from the courts through a privately concocted alternative arrangement, even one fairly negotiated.

The common theme of these decisions is that a disproportion between the stipulated and the anticipated damage justifies an inference of overcompensation. In turn, overcompensation implies either bargaining unfairness or an objectionable *in terrorem* agreement to secure performance. This line of reasoning suggests two benefits which may be expected from the current rule invalidating penalties. First, the cost of identifying unfairness may be reduced by a standard rule-of-thumb based on disproportion. Second, an enforceable *in terrorem* clause might discourage promisors from breaching and reallocating resources where changed circumstances would ordinarily create efficiency gains from this behavior. Inducing performance under these conditions is a misallocation which prevents the net social gain that would result from nonperformance.

[T]his analysis incorrectly assumes that, rather than negotiating out of the penalty, the promisor who is subject to an *in terrorem* clause will inevitably undertake an inefficient performance. In addition, there is no basis for the apparent assumption that the premium placed by the promisee on performance is valueless. Indeed, the market paradigm on which the compensation standard is based requires a contrary presumption; a promisee has a recognizable utility in certain *in terrorem* provisions and this utility is frequently reflected in willingness to pay a price for such clauses.

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

*Questions for discussion of C&H Sugar and Lake River:*

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

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

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

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

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

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View the screencast video on [Liquidated Damages](#).

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## **Preparing for Class – Liquidated Damages**

We've finally reached the end of our course materials. This last topic is one of my favorites and I hope you have enjoyed reading and analyzing these two cases. Try to understand why courts limit the enforceability of liquidated damage clauses and whether that departure from contractual freedom can be justified.

Focus on applying the liquidated damage rules to *C&H Sugar* and once again on developing a deeper theory of what is motivating courts to scrutinize liquidated damage clauses so closely.

Notice that courts' approach to contractually specified damages significantly constrains parties' ability to determine for themselves what damages will be payable for breach. Reflect on other doctrines we have studied and consider whether those rules emphasize contractual freedom or instead limit parties' autonomy in some

significant way. You may find it useful to try to identify common themes in the cases that limit contractual freedom.

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**THE END**



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