

[Note: Numbers in brackets refer to the printed pages of the Emanuel Law Outline where the topic is discussed.]

Emanuel Law Outlines Contracts

Chapter 1 INTRODUCTION

I. MEANING OF "CONTRACT"

A. Definition: A "contract" is an agreement that the law will enforce.

1. Written v. oral contracts: Although the word "contract" often refers to a written document, a writing is not always necessary to create a contract. An agreement may be binding on both parties even though it is oral. Some contracts, however, must be in writing under the Statute of Frauds.

II. SOURCES OF CONTRACT LAW

A. The UCC: Contract law is essentially common law, i.e. judge-made, not statutory. However, in every state but Louisiana, sales of *goods* are governed by a statute, Article 2 of the Uniform Commercial Code.

1. Common-law: If the UCC is silent on a particular question, the common law of the state will control. See [UCC § 1-103](#).

Chapter 2
OFFER AND ACCEPTANCE

I. INTENT TO CONTRACT

A. Objective theory of contracts: Contract law follows the *objective theory of contracts*. That is, a party's intent is deemed to be what a *reasonable person* in the position of the other party would think that the first party's objective manifestation of intent meant. For instance, in deciding whether *A* intended to make an offer to *B*, the issue is whether *A*'s conduct reasonably indicated to one in *B*'s position that *A* was making an offer. [10 - 11]

Example: *A* says to *B*, "I'll sell you my house for \$1,000." If one in *B*'s position would reasonably have believed that *A* was serious, *A* will be held to have made an enforceable offer, even if subjectively *A* was only joking.

B. Legal enforceability: The parties' intention regarding whether a contract is to be *legally enforceable* will normally be effective. Thus if both parties intend and desire that their "agreement" not be legally enforceable, it will not be. Conversely, if both desire that it be legally enforceable, it will be even if the parties mistakenly believe that it is not. [11 - 12]

Example: Both parties would like to be bound by their oral understanding, but mistakenly believe that an oral contract cannot be enforceable. This arrangement will be enforceable, assuming that it does not fall within the Statute of Frauds.

1. Presumptions: Where the evidence is ambiguous about whether the parties intended to be bound, the court will follow these rules: (1) In a "*business*" context, the court will presume that the parties intended their agreement to be legally enforceable; (2) but in a *social* or *domestic* situation, the presumption will be that legal relations were *not* intended.

Example: Husband promises to pay a monthly allowance to Wife, with whom he is living amicably. In the absence of evidence otherwise, this agreement will be presumed not to be intended as legally binding, since it arises in a domestic situation.

C. Intent to put in writing later: If two parties agree (either orally or in a brief writing) on all points, but decide that they will subsequently put their entire agreement into a more formal written document later, the preliminary agreement may or may not be binding. In general, the parties' *intention* controls. (*Example:* If the parties intend to be bound right away based on their oral agreement, they will be bound even though they expressly provide for a later formal written document.) [12 - 13]

1. Where no intent manifested: Where the evidence of intent is ambiguous, the court will generally treat a contract as existing as soon as the mutual assent is reached, even if no formal document is ever drawn up later. But for very large deals (e.g., billion dollar acquisitions), the court will probably find no intent to be bound until the formal document is signed.

II. OFFER AND ACCEPTANCE GENERALLY

A. Definitions: [14]

1. "Offer" defined: An *offer* is "the manifestation of willingness to enter into a bargain," which justifies another person in understanding that his assent can conclude the bargain. In other words, an offer is something that creates a power of acceptance.

2. "Acceptance" defined: An *acceptance* of an offer is "a manifestation of assent to the terms thereof made by the offeree in a manner invited or required by the offer."

Example: *A* says to *B*, "I'll sell you my house for \$100,000, if you give me a check right now for \$10,000 and promise to pay the rest within 30 days." This is an offer. If *B* says, "Here is my \$10,000 check, and I'll have the balance to you next week," this is an acceptance. After the acceptance occurs, the parties have an enforceable contract (assuming that there is no requirement of a writing, as there probably would be in this situation).

B. Unilateral vs. bilateral contracts: An offer may propose either a bilateral or a unilateral contract. [14 - 15]

1. Bilateral contract: A *bilateral* contract is a contract in which *both* sides make *promises*. (Example: *A* says to *B*, "I promise to pay you \$1,000 on April 15 if you promise now that you will walk across the Brooklyn Bridge on April 1." This is an offer for a bilateral contract, since *A* is proposing to exchange his promise for *B*'s promise.)

2. Unilateral contract: A *unilateral* contract is one which involves an exchange of the *offeror's promise* for the *offeree's act*. That is, in a unilateral contract *the offeree does not make a promise*, but instead simply acts.

Example: *A* says to *B*, "If you walk across the Brooklyn Bridge, I promise to pay you \$1,000 as soon as you finish." *A* has proposed to exchange his promise for *B*'s *act* of walking across the bridge. Therefore, *A* has proposed a unilateral contract.

III. VALIDITY OF PARTICULAR KINDS OF OFFERS

A. Offer made in jest: An offer which the offeree knows or should know is made *in jest* is not a valid offer. Thus even if it is "accepted," no contract is created. [16]

B. Preliminary negotiations: If a party who desires to contract *solicits bids*, this solicitation is not an offer, and cannot be accepted. Instead, it merely serves as a basis for preliminary negotiations. [16]

Example: *A* says, "I would like to sell my house for at least \$100,000." This is almost certainly a solicitation of bids, rather than an offer, so *B* cannot "accept" by saying, "Here's my check for \$100,000."

C. Advertisements: Most *advertisements* appearing in newspapers, store windows, etc., are *not* offers to sell. This is because they do not contain sufficient words of commitment to sell. (*Example:* A circular stating, "Men's jackets, \$26 each," would not be an offer to sell jackets at that price, because it is too vague regarding quantity, duration, etc.) [19]

1. Specific terms: But if the advertisement contains specific words of commitment, especially a promise to sell a *particular number* of units, then it may be an offer. (*Example:* "100 men's jackets at \$26 apiece, first come first served starting Saturday," is so specific that it probably is an offer.)

2. Words of commitment: Look for words of *commitment* – these suggest an offer. (*Example:* "Send three box tops plus \$1.95 for your free cotton T-shirt," is an offer even though it is also an advertisement; this is because the advertiser is committing himself to take certain action in response to the consumer's action.)

D. Auctions: When an item is put up for *auction*, this is usually *not* an offer, but is rather a solicitation of offers (bids) from the audience. So unless the sale is expressly said to be "without reserve," the auctioneer may withdraw the goods from the sale even after the start of bidding. See [UCC § 2-328\(3\)](#). [20]

IV. THE ACCEPTANCE

A. Who may accept: An offer may be accepted *only by a person in whom the offeror intended to create a power of acceptance*. [23]

Example: *O* says to *A*, "I offer to sell you my house for \$100,000." *B* overhears, and says, "I accept." Assuming that *O*'s offer was reasonably viewed as being limited to *A*, *B* cannot accept even though the consideration he is willing to give is what *O* said he wanted.

B. Offeree must know of offer: An acceptance is usually valid only if the offeree *knows of the offer* at the time of his alleged acceptance.

1. Rewards: Thus if a *reward* is offered for a particular act, a person who does the act without knowing about the reward cannot claim it.

C. Method of acceptance: The offeror is the "*master of his offer*." That is, the offeror may prescribe the *method* by which the offer may be accepted (e.g., by telegram, by letter, by mailing a check, etc.). [26 - 31]

1. Where method not specified: If the offer does not specify the mode of acceptance, the acceptance may be given in *any reasonable* method. [26]

2. Acceptance of unilateral contract: An offer for a unilateral contract is accepted by *full performance* of the requested act. [26]

Example: *A* says to *B*, "I'll pay you \$1,000 if you cross the Brooklyn Bridge." This can only be accepted by *A*'s act of completely crossing the bridge. (However, the offer will be rendered temporarily irrevocable once *B* starts to perform, as discussed below.)

3. Offer invites either promise or performance: If the offer does not make clear whether acceptance is to occur through a promise or performance, the offeree may accept by *either* a promise or performance. [27]

a. Shipment of goods: For instance, if a buyer of goods places a "purchase order" that does not state how acceptance is to occur, the seller may accept by either promising to ship the goods, or by in fact shipping the goods. [UCC § 2-206\(1\)\(b\)](#).

b. Accommodation shipment: If the seller is "accommodating" the buyer by shipping what the seller knows and says are *non-conforming goods*, this does *not* act as an acceptance. In this "*accommodation shipment*" situation, the seller is making a counter-offer, which the buyer can then either accept or reject. If the buyer accepts, there is a contract for the quantity and type of goods actually sent by the seller, not for those originally ordered by the buyer. If the buyer rejects, he can send back the goods. In any event, seller will not be found to be in breach. [UCC § 2-206\(1\)\(b\)](#). [28]

4. Notice of acceptance of unilateral contract: Where an offer looks to a unilateral contract, most courts now hold that the offeree must give *notice* of his acceptance after he has done the requested act. If he does not, the contract that was formed by the act is discharged. [29]

Example: *A* says to *B*, "I'll pay you \$1,000 if you cross the Brooklyn Bridge by April 1." *B* crosses the bridge on time. As soon as *B* crosses, a contract is formed. But if *B* does not notify *A* within a reasonable time thereafter that he has done so, *A*'s obligation will be discharged.

5. Acceptance by silence: Generally, an offer cannot be accepted by *silence*. But there are a few exceptions: [29 - 30]

a. Reason to understand: Silence can constitute acceptance if the offeror has given the offeree *reason to understand* that silence will constitute acceptance, and the offeree subjectively intends to be bound.

b. Benefit of services: An offeree who silently receives the benefit of *services* (but not goods) will be held to have accepted a contract for them if he: (1) had a reasonable opportunity to reject them; and (2) knew or should have known that the provider of the services expected to be compensated.

c. Prior conduct: The *prior course of dealing* may make it reasonable for the offeree's silence to be construed as consent. (*Example:* Each time in the past, Seller responds to purchase orders from Buyer either by shipping, or by saying, "We don't have the item." If Seller now remains silent in the face of an order by Buyer for a particular item, Seller's silence will constitute an acceptance of the order.)

d. Acceptance by dominion: Where the offeree receives *goods*, and *keeps them*, this exercise of "dominion" is likely to be held to be an acceptance.

V. ACCEPTANCE VARYING FROM OFFER

A. Common law "mirror image" rule: Under the common law, the offeree's response operates as an acceptance only if it is the *precise mirror image* of the offer. If the response conflicts at all with the terms of the offer, or adds new terms, the purported acceptance is in fact a rejection and counter offer, not an acceptance. [32 - 33]

Example: *A* writes to *B*, "I'll sell you my house for \$100,000, closing to take place April 1." *B* writes back, "That's fine; let's close April 2, however." At common law, *B*'s response is not an acceptance because it diverges slightly from the offer, so there is no contract.

B. UCC view: The UCC *rejects the "mirror image" rule*, and will often lead to a contract being formed even though the acceptance diverges from the offer.

Wherever possible, the UCC tries to find a contract, so as to keep the parties from weaseling out (as they often try to do when the market changes). This entire "battle of the forms" is dealt with in [UCC § 2-207](#), probably the most important UCC provision for the Contracts student. [34 - 35]

1. General: At the most general level, [§ 2-207\(1\)](#) provides that any "*expression of acceptance*" or "*written confirmation*" will *act as an acceptance* even though it states terms that are "additional to or different from" those contained in the offer.

Example: Buyer sends a "purchase order" containing a warranty. Seller responds with an "acknowledgement," containing a disclaimer of warranty. There will be a contract under the UCC, even though there would not have been one at common law.

2. Acceptance expressly conditional on assent to changes: An "expression of acceptance" does *not* form a contract if it is "*expressly made conditional on assent to...additional or different terms.*" [§ 2-207\(1\)](#). So if the purported "acceptance" contains additional or different terms from the offer, and also states something like, "This acceptance of your offer is effective only if you agree to all of the terms listed on the reverse side of this acceptance form," *there is no contract* formed by the exchange of documents. [36 - 40]

a. Limited: Courts are reluctant to find that this section applies. Only if the second party's form makes it clear that that party is *unwilling to proceed with the transaction* unless the first party agrees to the second party's changes, will the clause be applied so as to prevent a contract from forming.

3. "Additional" term in acceptance: Where the offeree's response contains an "*additional*" term (i.e., a clause taking a certain position on an issue with which the offer does not deal at all), the consequences depend on whether both parties are merchants. [41 - 43]

a. At least one party not merchant: If at least one party is *not a merchant*, the additional term does not prevent the offeree's response from giving rise to a contract, but the additional term becomes part of the contract only if the offeror *explicitly* assents to it.

Example: Consumer sends a purchase order to Seller, which does not mention how disputes are to be resolved. Seller sends an acknowledgement form back to Consumer, which correctly recites the basic terms of the deal (price, quantity, etc.), and then says, "All disputes are to be arbitrated."

Even though the acknowledgement (the "acceptance") differed from the purchase order by introducing the arbitration term, the acknowledgement formed a contract. However, since at least one party (Consumer) was not a merchant, this additional term will only become part of the contract if Consumer explicitly assents to that term (e.g., by initialing the arbitration clause on the acknowledgement form).

b. Both merchants: But if *both parties* to the transaction are "*merchants*," then the additional term *automatically becomes part of the contract*, as a general rule. (*Example:* On facts of prior example, if Buyer was a merchant, the arbitration clause would become part of the contract.) However, there are two important exceptions to this "additional term becomes part of the contract" rule:

i. Materiality: The addition will not become part of the contract if it is one which "*materially alters*" the contract. For instance, a *disclaimer of warranty* will always be found to materially alter the contract, so if the seller includes such a disclaimer in his acknowledgement form after receiving the buyer's purchase order, the disclaimer will not become part of the contract.

ii. Objection: If the offeror *objects* to having the additional term become part of the contract, it will not so become.

4. Acceptance silent: If an issue is handled in the first document (the offer), but *not in the second* (the acceptance), the acceptance will be treated as covering *all* terms of the offer, not just those on which the writings agree. [42 - 43]

Example: Buyer's purchase order says that disputes will be arbitrated; Seller's acknowledgement is silent on the issue of arbitration. The Seller's form will be found to be an acceptance, and disputes will be arbitrated.)

5. Conflicting terms in documents: If an issue is covered one way in the offering document and another (*conflicting*) way in the acceptance, most courts apply the "*knock out*" rule. That is, the conflicting clauses "knock each other out" of the contract, so that *neither enters the contract*. Instead, a UCC "gap-filler" provision is used if one is relevant; otherwise, the common law controls. [43 - 45]

Example: Buyer's purchase order states that disputes will be litigated in New York state court. Seller's acknowledgement form states that disputes will be arbitrated. Most courts would apply the "knock out" rule, whereby

neither the "New York courts" nor "arbitration" clauses would take effect. Instead, the common law – allowing an ordinary civil suit to be brought in any state that has jurisdiction – would apply.

6. Response diverges too much to be acceptance: If a purported acceptance *diverges greatly* from the terms of the offer, it will not serve as an acceptance at all, so *no contract is formed*. [45]

7. Contract by parties' conduct: If the divergence referred to in the prior paragraph occurs (so that the exchange of documents does not create a contract), the parties' *conduct* later on can still cause a contract to occur. [Section 2-207\(3\)](#) provides that "conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract." [45 - 47]

Example: Buyer's purchase order is for 100 widgets at \$5 each. Seller's acknowledgement form is for 200 widgets at \$7 each. Buyer does not say anything in response to the acknowledgement form. Seller ships the 200 widgets, and Buyer keeps them. Even though the exchange of documents did not create a contract, the parties' conduct gave rise to a contract by performance. [46]

a. Terms: Where a contract by conduct is formed, the terms "consist of those terms in which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act." [§ 2-207\(3\)](#). For instance, the price term would be a "reasonable price at the time for delivery," as imposed by [§ 2-305's](#) price "gap filler."

8. Confirmation of oral contract: If the parties initially reach an *oral agreement*, a document later sent by one of them memorializing the agreement is called a "*confirmation*." [47 - 50]

a. Additional terms in confirmation: If the confirmation contains a term that is *additional* to the oral agreement, that additional term becomes part of the contract unless either: (1) the additional term *materially alters* the oral agreement; or (2) the party receiving the confirmation *objects* to the additional terms.

b. "Different" term in confirmation: If a clause contained in the confirmation is "*different*" from a term on the same issue reached in the oral agreement, the new clause probably does *not* become part of the agreement.

VI. DURATION OF THE POWER OF ACCEPTANCE

A. General strategy: For an acceptance to be valid, it must become effective while the power of acceptance is still in effect. So where there is doubt about whether the acceptance is timely: (1) pinpoint the moment at which the "acceptance" became effective; and (2) ask whether the power of acceptance was still in effect at that moment. If the answer to part (2) is "yes," the acceptance was timely. [53]

B. Ways of terminating power of acceptance: The offeree's power of acceptance may be *terminated* in five main ways: (1) *rejection* by the offeree; (2) *counter-offer* by the offeree; (3) *lapse* of time; (4) *revocation* by the offeror; and (5) *death or incapacity* of the offeror or offeree. [53 - 58]

1. Rejection by offeree: Normally, if the offeree *rejects* the offer, this will terminate her power of acceptance. [54]

a. Exceptions: But rejection will not terminate the power of acceptance if either: (1) the offeror indicates that the offer still stands despite the rejections; or (2) the offeree states that although she is not now accepting, she wishes to consider the offer further later.

2. Counter-offer: If the offeree makes a *counter-offer*, her power to accept the original offer is terminated just as if she had flatly rejected the offer. [54 - 55]

Example: On July 1, *A* offers to sell *B* 100 widgets at \$5 each, the offer to be left open indefinitely. On July 2, *B* responds, "I'll buy 50 at \$4." *A* declines. On July 3, the market price of widgets skyrockets. On July 4, *B* tells *A*, "I'll accept your July 1 offer." No contract is formed, because *B*'s power of acceptance was terminated as soon as *B* made her counter-offer on July 2.

a. Contrary statement: But as with a rejection, a counter-offer does not terminate the power of acceptance if either offeror or offeree indicates otherwise. (*Example:* On facts of above example, if *B* said on July 2, "I'll buy 50 from you right now for \$4; otherwise, I'd like to keep considering your original offer," *A*'s offer would have remained in force.)

3. Lapse of time: The offeror, as "master of his offer," can set a *time limit* for acceptance. At the end of this time limit, the offeree's power of acceptance automatically terminates. [55 - 56]

a. End of reasonable time: If the offeror does not set a time limit for acceptance, the power of acceptance terminates at the end of a *reasonable* time period.

i. Face-to-face conversation: If the parties are bargaining face-to-face or over the phone, the power of acceptance continues *only during the conversation*, unless there is evidence of a contrary intent.

4. Revocation: The offeror is free to *revoke* his offer *at any time* before it is accepted (except in the case of option contracts). [56 - 58]

a. Effective upon receipt: A revocation by the offeror does not become effective until it is *received by the offeree*.

Example: On June 15, *A* mails an offer to *B*. On July 1, *A* mails a revocation to *B*. On July 3, *B* has a letter of acceptance hand delivered to *A*. On July 5, *A*'s revocation is received by *B*. *B*'s acceptance is valid, because *A*'s revocation did not take effect until its receipt by *B*, which was later than the July 3 date on which *B*'s acceptance took effect.

i. Lost revocation: If the letter or telegram revoking the offer is *lost* through misdelivery, the revocation *never becomes effective*.

5. Death or incapacity of offeror or offeree: If either the offeror or offeree *dies* or loses the *legal capacity* to enter into the contract, the power to accept is terminated. This is so even if the offeree does not learn of the offeror's death or incapacity until after he has dispatched the "acceptance." [58]

Example: On July 1, *A* sends an offer. On July 2, *A* dies. On July 3, *B* telegraphs her "acceptance." On July 4, *B* learns of *A*'s death. There is no contract.

C. Irrevocable offers: The ordinary offer is *revocable* at the will of the offeror. (This is true even if it states something like, "This offer will remain open for two weeks.") However, there are some exceptions to this general rule of revocability: [59 - 61]

1. Standard option contract: First, the offeror may grant the offeree an *"option"* to enter into the contract. The offer itself is then referred to as an "option contract." [59]

a. Common law requires consideration: The traditional common-law view is that an option contract can be formed only if the offeree gives the offeror *consideration* for the offer.

b. Modern (Restatement) approach: But the modern approach, as shown in the Restatement, is that a *signed* option contract that *recites* the payment of consideration will be irrevocable, even if the consideration was never paid.

2. "Firm offers" under the UCC: The UCC is even more liberal in some cases: it allows formation of an irrevocable offer even if no recital of the payment of consideration is made. By § 2-205, an offer to buy or sell goods is irrevocable if it: (1) is by a *merchant* (i.e., one dealing professionally in the kind of goods in question); (2) is in a *signed writing*; and (3) gives explicit assurance that the offer will be held open. Such an offer is irrevocable even though it is without consideration or even a recital of consideration. [60]

Example: Jeweler gives Consumer a signed document stating, "For the next 120 days, I agree to buy your two-carat diamond antique engagement ring for \$4,000." Even though Consumer has not paid consideration for the irrevocability, and even though there is no recital of consideration in the signed offer, Jeweler's offer is in fact irrevocable for 120 days, because it is by a merchant (Jeweler professionally sells or buys goods of the kind in question), is in a signed writing, and explicitly assures that the offer will be held open.

a. Three month limit: No offer can be made irrevocable for any longer than *three months*, unless consideration is given. § 2-205.

b. Forms supplied by offeree: If the firm offer is on a form drafted by the *offeree*, it is irrevocable only if the particular "firm offer" clause is *separately signed* by the offeror.

3. Part performance or detrimental reliance: The offeree's part performance or detrimental reliance (e.g., preparations to perform) may transform an otherwise-revocable offer into a temporarily irrevocable one. [61 - 65]

a. Offer for unilateral contract: Where the offer is for a *unilateral* contract, the *beginning of performance* by the offeree makes the offer *temporarily irrevocable*. As long as the offeree continues diligently to perform, the offer remains irrevocable until he has finished. [61]

Example: *A* says to *B*, "I'll pay you \$1,000 if you cross the Brooklyn Bridge anytime in the next three hours." Before *B* starts to cross the bridge, *A* may revoke. But once *B* starts to cross the bridge, *A*'s offer becomes temporarily irrevocable. If *B* crosses the bridge within three hours, a contract is formed and *A* owes *B* the

money. If *B* starts to cross, then changes his mind, neither party will be bound.

i. Preparations: This doctrine applies only to the beginning of *actual performance*, not the making of *preparations* to perform. (*Example:* On facts of above example, if *B* went out and bought expensive walking shoes in preparation for crossing, this act would not cause his offer to be irrevocable.)

b. Preparations by Offeree: If the offer is for a *bilateral* contract (i.e., a contract which is to be accepted by a return promise), the offeree's making of *preparations* will cause the offer to be temporarily irrevocable if justice requires. "An offer which the offeror should reasonably expect to induce action or forbearance of substantial character on the part of the offeree before acceptance and which does induce such action or forbearance is binding as an option contract *to the extent necessary to avoid injustice.*" Rest.2d, § 87(2). [65]

i. Offers by sub-contractors: Most importantly, an offer by a *sub-contractor* to a general contractor will often become temporarily irrevocable under this rule.

Example: *A*, sub-contractor, offers to supply steel to *B* on a job where *B* is bidding to become the general contractor. *B* calculates his bid in reliance on the figure quoted by *A*. *B* gets the job. Before *B* can accept, *A* tries to revoke.

If *B* can show that he bid a lower price because of *A*'s sub-bid, the court will probably hold *A* to the contract, or at least award *B* damages equal to the difference between *A*'s bid and the next-lowest available bid. But observe that *B*, the offeree, is *not* bound, so *B* could accept somebody else's sub-bid.

VII. WHEN ACCEPTANCE BECOMES EFFECTIVE

A. Mailbox rule: In most courts, the acceptance is *effective upon proper dispatch*. This is called the "*mailbox*" rule. [67 - 71]

Example: On July 1, *A* offers to sell 100 widgets to *B* at \$5 apiece. On July 2, *B* deposits a properly-addressed acceptance in the mail. On July 10, *A* finally receives the letter, several days later than would ordinarily be expected from first-class mail. A contract was formed on July 2. Any attempt at revocation by *A* on, say, July 5 would have been ineffective.

1. Offer provides otherwise: The "mailbox" rule does not apply if the offer provides otherwise (e.g., "This offer will be accepted when and if your letter of acceptance is personally received by me").

2. Lost in transmission: If the acceptance is *lost in transmission* or *delayed*, the applicability of the mailbox rule depends on whether the communication was properly addressed.

a. Properly addressed: If the acceptance is *properly addressed*, it is effective at the time of dispatch even if it is lost and *never received* by the offeror at all. (But a court might "discharge" the offeror in this circumstance, for instance if he had sold the goods to someone else.)

b. Not properly addressed: If the acceptance is *not* properly addressed, or not properly dispatched (e.g., sent by an unreasonably slow means), it will be effective upon dispatch only if it is received within the time in which a properly dispatched acceptance would normally have arrived. If it comes later than this "normal" time, it will not be effective until receipt.

B. Both acceptance and rejection sent by offeree: If the offeree sends *both* an acceptance and rejection, the rule depends on which is dispatched first. [71 - 73]

1. Rejection sent first: If the *rejection* is sent first, then the acceptance will be effective if (and only if) the offeror receives it before he receives the rejection.

2. Acceptance dispatched first: If the acceptance is sent before the rejection, the acceptance is effective upon dispatch, and the subsequently-dispatched "rejection" (really a "revocation of acceptance") does not undo the acceptance, whether that rejection is received by the offeror before or after he receives the acceptance.

C. Option contracts: The acceptance of an *option contract* is effective upon *receipt* by the offeror, *not upon dispatch*. [73]

D. Risk of mistake in transmission: The risk of a *mistake in transmission* of the terms of the offer is upon the offeror. That is, a contract is formed on the terms of the offer *as received by the offeree*. [73]

Example: *A* intends to offer to sell 100 widgets at \$5 each. Instead, the telegraph company transmits the offer as an offer to sell 200 widgets at \$4. If *B* accepts without knowledge of the error, *A* will be stuck having to sell 200 widgets at \$4.

1. No right to "snap up" obviously wrong offer: However, if the offeree *knows* or *should reasonably have known* that the offer has undergone a mistake in transmission, she *cannot* "snap up" the offer.

VIII. INDEFINITENESS

A. Generally: No contract will be found if the terms of the parties' "agreement" are unduly *indefinite*. (Example: *A* and *B* agree that *B* will buy widgets from *A* from time to time. The parties do not decide anything about quantity, price, delivery, etc. A court would probably find that even though *A* and *B* may have meant to conclude a binding agreement, the absence of terms makes their agreement void for indefiniteness.) [76]

1. Court supplies missing term: But if the court believes that the parties intended to contract, and the court believes that it can supply a "*reasonable*" value for the missing term, it will generally do so. [77]

a. UCC: The UCC expressly allows the court to fill in terms for price, place for delivery, time for shipment, time for payment, etc., as long as the parties have intended to make a contract. See § 2-204(3). The UCC also implies a term requiring *good faith* in every contract for the sale of goods. § 1-203. [77 - 80]

b. Non-UCC: In non-UCC cases, most modern courts follow this "supply the missing term on a reasonable basis" approach, as long as the parties have shown an intent to create a binding contract. [80]

c. Too indefinite: But there may be situations where even though the parties intended to create a binding contract, they have fleshed out the terms of their deal so little that the court simply cannot meaningfully supply all of the missing terms. In that case, the court will find the agreement void for indefiniteness. (But this is rare.) [80 - 81]

2. Agreement to agree: Similarly, the court will generally supply a missing term if the parties intentionally leave that term to be *agreed upon later*, and they then don't agree. See, e.g., UCC § 2-305(1)(b), which allows the court to supply a reasonable *price* term if "the price is left to be agreed by the parties and they fail to agree...." [81]

3. Part performance: Even if an agreement is too indefinite for enforcement at the time it is made, the *subsequent performance* of the parties may cure this indefiniteness. [83]

Example: *A* contracts to make a suit for *B*, without specifying the type or color of material to be used. This is probably unenforceable for indefiniteness when made. But if *A* begins to make the suit with gray cotton cloth, and *B* raises no objection, the indefiniteness will be cured by this part performance.

IX. MISUNDERSTANDING

A. General rule: If the parties have a *misunderstanding* about what they are agreeing to, this may prevent them from having the required "meeting of the minds," and thus prevent a contract from existing. No contract will be formed if: (1) the parties each have a different subjective belief about a term of the contract; (2) that term is a material one; and (3) neither party knows or has reason to know of the misunderstanding. [83 - 85]

Example: *A* offers to ship goods to *B* on the steamer "Peerless." *B* accepts. Unknown to both, there are in fact two steamships by this name. *A* intends to use the later one; *B* subjectively intends to get shipment on the earlier one. Because both are in subjective disagreement about the meaning of a material term, and neither has reason to know of the disagreement, there is no contract. [*Raffles v. Wichelhaus*]

1. Fault: Conversely, if one party *knows* or *should know* that he has a different understanding as to the meaning of an ambiguous term than the other, a contract will be formed on the term as understood by the other (innocent) party.

Example: Same facts as above example. This time, *A* knows or should know that there are two Peerlesses, and knows or should know that *B* means the earlier one. *B* doesn't and shouldn't know that there are two. *A* contract is formed for shipment on the earlier (the one understood by *B*, the "innocent" party).

B. Offeree doesn't understand offer: Where the offeree fails to *understand* or *read* the offer, a similar "fault" system applies: [84 - 85]

1. Offeree is negligent: If the offeree's failure to read or understand the offer is due to his own negligence, he is bound by the terms of the contract as stated in the offer.

2. Misrepresentation: But if the offeree's misunderstanding is due to the offeror's *misrepresentation* of the terms of the offer, and the offeror knows this, there is a contract on the terms as understood by the offeree.

Chapter 3
CONSIDERATION

I. INTRODUCTION

A. Definition of consideration: As a general rule, a contract will not be enforceable unless it is supported by "consideration." (The few exceptions are treated in "Promises binding without consideration" below.) A promise is supported by consideration if: [95]

1. Detriment: The promisee *gives up something of value*, or circumscribes his liberty in some way (i.e., he suffers a "*legal detriment*"); *and*

2. Exchange: The promise is given as part of a "*bargain*"; that is, the promisor makes his promise *in exchange* for the promisee's giving of value or circumscription of liberty.

B. Uses of doctrine: The requirement of consideration renders unenforceable two main types of transactions: [95 - 97]

1. Promises to *make gifts* (which do not satisfy the "bargain" element); *and*

2. Business situations in which one party has *not really promised to do something* or given anything up, even though he may appear to have done so (the "detriment" element is missing here).

II. THE BARGAIN ELEMENT

A. Promises to make gifts: A *promise to make a gift* is generally *unenforceable*, because it lacks the "bargain" element of consideration. [97 - 103]

Example: *A* says to *B*, his daughter, "When you turn 21 in four years, I will give you a car worth \$10,000." The four years pass, *A* refuses to perform, and *B* sues for breach of contract. *B* will lose, because there was no consideration for *A*'s promise. In particular, *A*'s promise was not "bargained for."

1. Existence of condition: Even if the person promising to make a gift requires the promisee to meet certain *conditions* in order to receive the gift, there will still be no consideration (and the promise will thus be unenforceable) if the meeting of the conditions is not really "bargained for" by the promisor. [97 - 103]

Example: *A* promises his widowed sister-in-law *B* a place to live "if you will come down and see me." In response, *B* travels to see *A*, thereby incurring expenses. Even though *B* has suffered a "detriment" (the

expenses), the "bargain" element is lacking – *A* was not promising *B* a place to live because he wanted to see her, but was merely imposing a necessary pre-condition for her to get the gift. Therefore, his promise is unenforceable for lack of consideration. [*Kirksey v. Kirksey*]

a. Occurrence of condition is of benefit to promisor: But if the promisor imposes a condition, and the occurrence of this condition is of *benefit* to him, then the bargain element probably *will* be present.

Example: *A* promises his nephew *B* \$5,000 if *B* will refrain from smoking, drinking and gambling until age 21. *B* so abstains. Here, *A*'s promise was "bargained for" (and thus supported by consideration), because *A* was attempting to obtain something he regarded as desirable. [*Hamer v. Sidway*]

i. Altruistic pleasure not sufficient: But the fact that one who promises to make a gift expects to derive *altruistic pleasure*, or love and affection, from making the gift is *not* sufficient to constitute a "bargain."

2. Executed gifts: It is only the *promise* to make a gift, not the actual making of a gift, that is unenforceable for lack of consideration. Once the promisor makes the gift, he cannot rescind it for lack of consideration. [103]

B. Sham and nominal consideration: Even though a deal looks on its face as if it is supported by consideration, the court may conclude that the purported consideration is *sham* or *nominal*, and is thus not consideration at all. [101]

1. Nominal amount: Thus where the "consideration" that has been paid is so small as to be *nominal*, the court may conclude as a factual matter that there is no real "bargain" present at all. If so, the promise will not be enforced, due to lack of consideration.

Example: *A* says to *B*, his son, "In consideration for \$1 paid and received, I promise to give you a car worth \$10,000 four years from now." Even if the \$1 is actually paid, the court will probably conclude that *A* did not "bargain" for the \$1, and that there is thus no consideration; *A*'s promise will therefore be unenforceable.

a. "Adequacy" irrelevant: But if the consideration is big enough to suggest that there was a bargain, the fact that it is "inadequate" is irrelevant. (See *infra*.)

2. Payment not in fact made: If a non-trivial payment is recited, but the payment was *not in fact made*, most courts will take this as evidence that no bargain was present. Always, the question is whether there was in fact a bargain, and payment or non-payment is merely non-dispositive evidence of whether there was a bargain.

C. Promisee unaware: Generally, the promisee must be *aware* of the promise, for the act performed by him to be consideration for the promise. This means that if a *reward* is promised for a certain act, and the act is performed without the actor's being aware of the reward, he cannot recover. [102]

D. "Past consideration" no good: If the promise is made in return for detriment *previously* suffered by the promisee, there is no bargain, and thus no consideration. Thus promises to pay a pre-existing debt, and promises to pay for services already received, usually lack the "bargain" element (but these may be binding even without consideration, as discussed below). [103 - 104]

III. THE "DETRIMENT" ELEMENT

A. Generally: For consideration to be present, the promisee must suffer a *"detriment."* That is, she must do something she does not have to do, or refrain from doing something that she has a right to do. (*Example:* After P has already retired from working for D, D promises P a lifetime pension, for which P need not do anything. At common law, this promise would probably be unenforceable, because P has not suffered any detriment in return for it.) [106]

1. Non-economic detriment: Even a *non-economic* detriment will suffice. (*Example:* If A promises B \$5,000 in return for B's abstaining from alcohol and tobacco, B's refraining will be a "detriment" that will serve as consideration for A's promise. Thus A's promise will be enforceable.) [106]

2. Adequacy not considered: The court will *not* inquire into the *"adequacy"* of the consideration. As long as the promisee suffers some detriment, no matter how small, the court will not find consideration lacking merely because what the promisee gave up was of much less value than what he received. [110 - 112]

Example: D is desperate for funds during WWII, and promises to pay P \$2,000 after the war in return for \$25 now. Held, there is consideration for D's promise, so P may collect. Mere "inadequacy of consideration" is no defense. [*Batsakis v. Demotsis*].

a. Lack of bargain: But remember that extreme disparity in value between what the promisee gives up and receives may suggest that

there is not in fact a "bargain," in which case there will be no consideration even though the detriment requirement is satisfied.

B. Pre-existing duty rule: If a party does or promises to do what he is *already legally obligated* to do, or if he forbears or promises to forbear from doing something which he is *not legally entitled to do*, he has not incurred a "detriment" for purposes of consideration. This is the *pre-existing duty* rule. [112]

1. Modification: This general rule means that if parties to an existing contract agree to *modify* the contract for the sole benefit for one of them, the modification will usually be unenforceable at common law, for lack of consideration. Be on the lookout for this scenario especially in *construction* cases. [112 - 115]

a. Restatement: The Second Restatement, and most modern courts, follow this general rule, but they make an exception where the modification is "fair and equitable in view of circumstances *not anticipated* by the parties when the contract was made."

2. Extra duties: Even under the traditional pre-existing duty rule, if the party who promises to do what he is already bound to do assumes the *slightest additional duties* (or even *different* duties), his undertaking of these new duties *does* constitute the required "detriment." [115]

3. UCC: For contracts for the sale of goods, the UCC *abolishes the pre-existing duty rule*. [Section 2-209\(1\)](#) provides that "an agreement modifying a contract needs no consideration to be binding." But there must be good faith, and any no-oral-modification clause must be complied with. [115]

4. Agreement to accept part payment of debt: Some courts apply the pre-existing duty rule to render unenforceable a creditor's promise *not to require payment* by his debtor *of the full debt*. These courts also treat as unenforceable a creditor's promise to allow the debtor *extra time* to pay. These courts reason that the debtor already owes the money, and is therefore not promising to do something he was not already required to do. This is known as the rule of *Foakes v. Beer*. [116 - 118]

a. Modern trend: But the modern trend is to abolish or limit the rule of *Foakes v. Beer*. For instance, the UCC, in [§ 2-209\(1\)](#), says that "an agreement modifying a contract within this article needs no consideration to be binding...." This seems to overrule *Foakes v. Beer*, and to make a seller's promise to take partial payment in return for goods enforceable.

b. Disputed debt: Also, the rule of *Foakes v. Beer* applies only to debts where the parties are in agreement about amount and liability, called "*liquidated*" debts. If the debtor in good faith and reasonably *disputes* his liability, or the *amount* of that liability, then a settlement by which the creditor agrees to take less than *he* thinks is due is *enforceable* (even in courts following the traditional *Foakes v. Beer* rule).

c. Cashing of check tendered as settlement: Debtors sometimes send a check for less than the amount due, and mark it "in full settlement." If the creditor writes "In protest" on the check, but cashes it, the UCC holds that the cashing normally constitutes an acceptance by the creditor of the proposed settlement, and the creditor cannot sue for the balance. § 3-311. [117]

5. Other settlements: Settlements of other kinds of suits (e.g., tort suits) will generally be found to meet the consideration requirement. But if the plaintiff surrenders a claim which he knows is *invalid*, this will not be consideration, and the other party need not pay. [119 - 120]

IV. ILLUSORY, ALTERNATIVE AND IMPLIED PROMISES

A. Illusory promises: An "*illusory*" promise is not supported by consideration, and is therefore not enforceable. An illusory promise is a statement which appears to be promising something, but which in fact does not *commit* the promisor to do anything at all. [124 - 129]

Example: *A* says to *B*, "I'll sell you as many widgets at \$4 apiece, up to 1,000, as you choose to order in the next 4 weeks." *B* answers, "Fine, we've got a deal." *B* then gives *A* an order for 100 widgets, and *A* refuses to sell at the stated price because the market has gone up. *B*'s promise is illusory, since she has not committed herself to do anything. Therefore, *A*'s promise is not supported by consideration, and is not binding on him.

1. Right to terminate: If the contract allows one or both parties to *terminate* the agreement at his option, this right of termination might make the promise illusory and the contract therefore unenforceable. [127]

a. Unfettered right: If the agreement allows one party to terminate simply by giving *notice at any time*, the traditional common law view is that the party with the termination right has not furnished consideration. But the modern trend is to hold that as long as the terminating party has the obligation to *give notice* (even if this obligation is an *implied* one), this duty of notice itself furnishes consideration.

B. Implied promises: Courts try to avoid striking down agreements for lack of consideration. One way they do this is by finding that the promisee has made an *implied promise* in return. [128 - 129]

Example: D, a fashion designer, gives P the exclusive right to sell products made from D's designs. P promises to pay royalties on any product sold, but the agreement does not expressly require P to make sales. D violates the agreement by letting someone else sell her designs. P sues D, who defends on the grounds that P did not really promise to do anything, and that there is thus no consideration for D's promise of exclusivity.

Held, for P – P can be impliedly found to have promised to use reasonable efforts to market D's designs, thus furnishing consideration for D's counter-promise. [*Wood v. Lucy, Lady Duff Gordon*].

Chapter 4

PROMISES BINDING WITHOUT CONSIDERATION

I. PROMISES TO PAY PAST DEBTS

A. General rule: Most states enforce a *promise to pay a past debt*, even though no consideration for the promise is given. Thus promises to pay debts that have been discharged by bankruptcy, or that are no longer collectible because of the statute of limitations, are enforceable in most states. [142 - 143]

1. Writing required: Most states require a *signed writing*, at least where the promise is to pay a debt barred by the statute of limitations.

II. PROMISE TO PAY FOR BENEFITS RECEIVED

A. Generally: A promise to pay for *benefits* or *services* one has previously received will generally be enforceable even without consideration. This is especially likely where the services were *requested*, or where the services were furnished without request in an *emergency*. [143 - 145]

III. OTHER CONTRACTS BINDING WITHOUT CONSIDERATION

A. Modification of sales contracts: Under the UCC, a *modification* of a contract for the sale of goods is binding without consideration. See § 2-209. [146]
(*Example:* A contracts to supply 100 widgets to B at \$4 a piece. Before shipment, A says, "My costs have gone up; I'll have to charge you \$5." B agrees. Under UCC § 2-209, this modification is enforceable, even though B received no consideration for promising to pay the higher price.)

1. No-oral-modification clauses: But a "no oral modifications" clause in a sales contract will normally be enforced. (*Example:* On the facts of the above example, if the original contract between A and B said that any modification must be in writing, B's promise to pay the higher price would be enforceable only if in writing.)

B. Option contracts: Recall that *option contracts* are sometimes enforceable without consideration. Thus an offer that purports to be enforceable, and that falsely recites that consideration was paid for the irrevocability, will be enforced in most courts. Also, remember that UCC § 2-205 renders enforceable "firm offers" under certain circumstances. [148]

C. Guaranties: In most states, a *guaranty* (that is, a promise to pay the debts of another) will be enforced without consideration. Generally, the guarantee must be in writing, and must state that consideration has been paid (though the consideration does not in fact have to have been paid). [148 - 149]

IV. PROMISSORY ESTOPPEL

A. General approach: Promises which foreseeably induce *reliance* on the part of the promisee will often be enforceable without consideration, under the doctrine of *promissory estoppel ("P.E.")*. Rest.2d, § 90's definition of the doctrine is as follows: "A promise which the promisor *should reasonably expect to induce action or forbearance* on the part of the promisee or a third person and which does induce such action or forbearance *is binding if injustice can be avoided only by enforcement of the promise.*" [151]

Example: *A* promises to pay for *B*'s college education if *B* will attend school full time. *A* intends this to be a gift. *B* gives up a good job and enrolls in college, incurring a liability of \$5,000 for the first year. *A* then refuses to pay the bill. Under the doctrine of P.E., *B* would be able to recover at least the value of the lost job and first-year tuition from *A*, even though *A*'s promise was a promise to make a gift and was thus not supported by consideration.

1. Actual reliance: The promisee must *actually rely* on the promise. (*Example:* On the facts of the above example, *B* must show that without *A*'s promise, *B* would not have quit his job and attended college.) [153]

2. Foreseeable reliance: The promisee's reliance must also have been *reasonably foreseeable* to the promisor. [153]

B. Possible applications:

1. Promise to make a gift: The P.E. doctrine is most often applied to enforce promises to *make gifts*, where the promisee relies on the gift to his detriment. [153]

a. Intra-family promises: The doctrine may be applied where the promise is made by one member of a *family* to another. (*Example:* Mother promises to pay for Son's college education, and Son quits his job. Probably the court will award just the damages Son suffers from losing the job, not the full cost of a college education.)

2. Charitable subscriptions: A written promise to make a *charitable contribution* will generally be binding without consideration, under the P.E. doctrine. Here, the doctrine is watered down: usually the charity does not need to show detrimental reliance. (But *oral* promises to make charitable contributions usually will not be enforceable unless the charity relies on the promise to its detriment.) [154]

3. Gratuitous bailments and agencies: If a person promises to *take care of* another's property (a "gratuitous bailment") or promises to carry out an act as another person's *agent* (gratuitous agency), the promisor may be

held liable under P.E. if he does not perform at all. (However, courts are hesitant to apply P.E. to promises to *procure insurance* for another.) [155]

4. Offers by sub-contractors: Where a *sub-contractor* makes a *bid* to a general contractor, and the latter uses the bid in computing his own master bid on the job, the P.E. doctrine is often used to make the sub-bid temporarily irrevocable. [156]

5. Promise of job: If an employer promises an *at-will job* to an employee, and then revokes the promise before the employee shows up for work, P.E. may apply. [157]

Example: *A* offers a job to *B*, terminable by either at any time. *B* quits his established job. Before *B* shows up for work, *A* cancels the job offer. A court might hold that even though *B* could have been fired at any time once he showed up, *B* should be able to collect the value of the job he quit from *A*, under a P.E. theory. [*Grouse v. Group Health Plan*]

6. Negotiations in good faith: A person who *negotiates* with another may be found to have a duty to *bargain in good faith*; if bad faith is found, the court may use P.E. to furnish a remedy. [158 - 161]

Example: *A*, owner of a shopping mall, promises that it will negotiate a lease for particular space with *B*, a tenant. *B* rejects an offer of space from another landlord. *A* then leases the space to one of *B*'s competitors for a higher rent. A court might apply P.E., by holding that *A* implicitly promised to use good faith in the negotiations and breached that promise.

a. Promises of franchise: The use of P.E. to protect negotiating parties is especially likely where the promise is a promise by a national corporation to award a *franchise* to the other party. (*Example:* *P*, a national company that runs a fast food chain, promises *B* a franchise. *B* quits his job and undergoes expensive training in the restaurant business. If *A* then refuses to award the franchise, a court might use P.E. to enforce the promise, at least to the extent of reimbursing *B* for his lost job and training expenses.)

C. Amount of recovery: Where P.E. is used, the damages awarded are generally limited to those necessary to "*prevent injustice.*" Usually, this will mean that the plaintiff receives *reliance* damages, rather than the greater expectation measure. In other words, *P* is placed in the position he would have been in had the promise never been made. [161 - 162]

Example: If *A* promises *B* a franchise, and *B* quits his job in reliance, the court will probably award *B* the value of the lost job, not the greater sum equaling profits that *B* would have made from the franchise.

Chapter 5
MISTAKE

I. MISTAKE GENERALLY

A. Definition: A "mistake" is a "*belief that is not in accord with the facts.*" [167 - 168]

1. Mutual mistake: If both parties have the same mistaken belief, the mistake is said to be "*mutual.*"

2. Unilateral: By contrast, if only one party has the mistaken belief, the mistake is "*unilateral.*"

3. Existing fact: The doctrines applicable to mistake apply only to a mistaken belief about an *existing fact*, *not* an erroneous belief about *what will happen in the future.*

Example: If Buyer and Seller both think that a stone is an emerald when it is in fact a topaz, this is a mistake. But if Buyer and Seller both think that the price of oil will remain relatively stable over the next five years, and in fact it goes up by 50% per year, this is not a mistake, since it does not relate to existing fact.

4. Mistake of law: A mistake about a *legal principle*, according to most courts today, can be a mistake.

II. MUTUAL MISTAKE

A. Three requirements for avoidance: Three requirements must be satisfied before the adversely-affected party may *avoid the contract* on account of *mutual mistake*: [169 - 170]

1. Basic assumption: The mistake must concern a *basic assumption* on which the contract was made. (*Examples:* The belief that a violin is a Stradavarius when it is in fact a worthless 20th century imitation is a "basic" mistake. But the seller's belief that a buyer to whom he is selling on credit is credit-worthy is probably a "collateral" rather than a "basic" mistake.)

2. Material effect: The mistake must have a *material effect* on the "agreed exchange of performance." (*Example:* If both Buyer and Seller thinks that a violin is a Stradavarius, but it is in fact a Guarnarius worth almost the same amount, the mistake would not have a "material effect" on the agreed exchange.)

3. Risk: The adversely-affected party (the one seeking to avoid the contract) must not be the one on whom the contract has implicitly *imposed the risk* of the mistake. Often, the contract does not make it clear which party is to bear the risk of a certain type of mistake, so the court allocates this risk in the manner that it finds to be "*reasonable*" in the circumstances.

B. Special contexts: [170 - 174]

1. Market conditions: Mistakes as to *market conditions* will generally *not* be "basic" ones, so the mistaken party will not be able to avoid the contract. (*Example:* Seller agrees to sell Blackacre to Buyer. Both parties believe that comparable land is worth \$5,000 per acre. Buyer can't avoid the contract if comparable land is really worth \$2,000 per acre.) [171]

2. Existence of subject matter: The *existence* of the subject matter of the contract is usually a "basic" assumption. [171 - 172]

Example: Seller agrees to sell land containing timber to Buyer. Both parties believe that there are 100,000 board feet on the property. In fact, fire has destroyed much of the timber, so that only 20,000 feet remain. This will be a basic assumption, so Buyer can avoid the contract when the facts emerge, whether this is before or after closing.

3. Quality of subject matter: A major mistake as to the *quality* of the contract's subject matter is often a "basic" assumption, so the disadvantaged party can avoid the contract. (*Example:* If both parties believe a violin is a Stradivarius when in fact it is an almost worthless imitation, this will be a mistake on a basic assumption, and Buyer can avoid the contract.) [171 - 172]

4. Minerals in land: In land-sale contracts, the Seller will almost always bear the risk that valuable *oil and gas* deposits will be found on the land (i.e., Seller cannot avoid the contract when such a discovery is made). [174]

5. Building conditions: When a builder contracts to *construct a building* on land owned by the other party, the builder will almost always be found to bear the risk of a mistake about soil or other unexpected conditions, so he cannot avoid the contract if construction proves much more difficult than expected. [174]

III. UNILATERAL MISTAKE

A. Modern view: Where the mistake is *unilateral*, it is more difficult for the mistaken party to avoid the contract than in the mutual mistake situation. The

mistaken party must make the same three showings as for mutual mistake (basic assumption, material effect, and risk on the other party), *plus* must show *either* that: [176 - 178]

1. Unconscionability: The mistake is such that enforcement of the contract would be *unconscionable*; or

2. Reason to know: The other party had *reason to know* of the mistake, or the other party's *fault* caused the mistake.

B. Construction bids: The most common type of unilateral mistake occurs where a *contractor* or sub-contractor makes an error on a *bid* for a construction job. [177 - 178]

1. Unconscionability: The mistaken contractor will succeed in showing unconscionability only if he shows that not only will he be *severely harmed* if forced to perform, but also that the other party *has not relied* on the bid.

Example: Sub-contractor gives contractor a bid of \$50,000 for electrical work. Contractor relies on this bid to prepare her own master bid for the entire project. Contractor gets the contract, enters into a sub-contract with Sub-contractor, and Sub-contractor then discovers that his \$50,000 bid should have been \$75,000, due to a clerical error. The court would probably not find it unconscionable to hold Sub-contractor to the contract, because Contractor has relied on the \$50,000 sub-bid.

2. "Snapping up" of offer: Alternatively, the mistaken contractor may try to show that the other party either *knew* or had *reason to know* of the error. (*Example:* On the above example, if Sub-contractor can show that Contractor should have known that there probably was a mistake, because Sub-contractor's bid was much lower than all other sub-bids, the court is likely to let Sub-contractor avoid the contract based on unilateral mistake.)

IV. DEFENSES AND REMEDIES

A. Negligence: Where a party seeks to avoid the contract because of his own (or both parties') mistake, the fact that the mistake was due to his *negligence* will ordinarily *not prevent relief*.

1. Failure to read writing: But if the mistake stems from a party's *failure to read the contract*, he will *not* normally be entitled to rescind. [180]

B. Remedies: There are two main *remedies* that may be appropriate for mistake: [180 - 181]

1. Avoidance: The most common remedy is *avoidance* of the contract (sometimes called "*rescission*"). Here, the court treats the contract as if it has never been made, and attempts to return each party to the position he was in just before the contract was signed. (Generally, *restitution* will be ordered – each party will return the benefits he has received from the other.)

2. Reliance: Alternatively, the court may award *reliance* damages, especially where restitution/ avoidance would not work because one party has suffered losses but the other has not received benefits.

V. REFORMATION AS REMEDY FOR ERROR IN EXPRESSION

A. Generally: If the parties orally agree on a deal, but mistakenly prepare and execute a document which *incorrectly reflects* the oral agreement, either party may obtain a court order for *reformation* (i.e., a re-writing of the document). [181 - 182]

Example: Seller orally agrees to sell Blackacre to Buyer for \$100,000. Their oral deal includes a provision that Buyer will also assume an existing mortgage of \$50,000. The written agreement neglects the assumption provision. At either party's request, the court will reform the document so that it includes the assumption provision.

Chapter 6
PAROL EVIDENCE AND INTERPRETATION

I. PAROL EVIDENCE RULE GENERALLY

A. What the rule does: The parol evidence rule limits the extent to which a party may establish that discussions or writings prior to the signed written contract should be taken as part of the agreement. In some circumstances, the rule bars the fact-finder from considering any evidence of certain preliminary agreements that are not contained in the final writing, even though this evidence might show that the preliminary agreement did in fact take place and that the parties intended it to remain part of their deal despite its absence from the writing. [186 - 187]

II. TOTAL AND PARTIAL INTEGRATIONS

A. Definitions: [[187]

1. "Integration": A document is said to be an *"integration"* of the parties' agreement if it is intended as the *final expression* of the agreement. (The parol evidence rule applies *only to documents which are "integrations,"* i.e., final expressions of agreement.)

2. Partial integration: A *"partial"* integration is a document that is intended to be final, but that is *not* intended to include *all details* of the parties' agreement.

3. Total integration: A *"total"* integration is a document that is not only a final expression of agreement, but that is also intended to include *all details* of the agreement.

B. Statement of rule: The "parol evidence rule" is in fact two sub-rules: [187 - 188]

1. Partial integration: When a writing is a *partial integration*, no evidence of prior or contemporaneous agreements or negotiations (oral or written) may be admitted if this evidence would *contradict* a term of the writing.

2. Total integration: When a document is a *total integration*, no evidence of prior or contemporaneous agreements or negotiations may be admitted which would *either contradict* or *add* to the writing.

3. Summary: Putting the two sub-parts together, the parol evidence rule provides that evidence of a prior agreement may never be admitted to *contradict an integrated writing*, and may furthermore not even *supplement* an integration which is intended to be *complete*.

4. Prior writings and oral agreements: The parol evidence rule applies to *oral agreements and discussions* that occur *prior* to a signing of an integration. It also applies to *writings* created prior to an integration (e.g., draft agreements that were not intended to be final expressions of agreement). [188]

5. Contemporaneous writing: If an *ancillary writing* is signed at the *same time* a formal document is signed, the ancillary document is treated as *part of the writing*, and will not be subject to the parol evidence rule.

6. Subsequent agreements: The parol evidence rule *never bars consideration of subsequent oral agreements*. That is, *a written contract may always be modified after its execution*, by an oral agreement.

a. **"No oral modifications" clause:** However, if the written document contains a *"no oral modification"* clause, that clause will usually be enforced by the court, unless the court finds that the defendant *waived* the benefits of that clause.

C. UCC: [Section 2-202 of the UCC](#) essentially follows the common-law parol evidence rule as summarized above. [192 - 193]

III. ROLES OF JUDGE AND JURY

A. Preliminary determinations made by judge: Nearly all courts hold that the *judge*, not the jury, decides: (1) whether the writing was intended as an integration; (2) if so, whether the integration is "partial" or "total"; and (3) whether particular evidence would supplement the terms of a complete integration. [195]

1. Conflicting views: Courts disagree about how the judge should make these decisions. Two extreme positions are: (1) the *"four corners"* rule, by which the judge decides whether there is an integration, and whether it is total or partial, by looking *solely at the document*; and (2) the "Corbin" view, by which these questions are to be answered by looking at *all available evidence*, including testimony, to determine the *actual intention* of the parties. [195 - 197]

2. Merger clause: Most contracts contain a *"merger" clause*, i.e., a clause stating that the writing constitutes the sole agreement between the parties. The presence of such a clause makes it more likely that the court will find the writing to have been intended as a total integration (in which case not even consistent additional prior oral or written terms may be shown). [195]

IV. SITUATIONS WHERE PAROL EVIDENCE RULE DOES NOT APPLY

A. Fraud, mistake or other voidability: Even if a writing is a total integration, a party may always introduce evidence of earlier oral agreements to show *illegality, fraud, duress, mistake, lack of consideration*, or any other fact that would make the contract void or voidable. In other words, the parol evidence rule never prevents the introduction of evidence that would show that *no valid contract exists* or that the contract is voidable. [198]

Example: In order to induce Buyer to buy a rental property, Seller lies about the profitability of the property. The parties then sign a sale contract that contains a standard "merger" clause, reciting that the contract constitutes the sole agreement between the parties. The parol evidence rule will not prevent Buyer from showing that Seller made fraudulent misrepresentations to induce him to enter into the contract.

1. Particular disclaimer: But if the contract contains a very specific statement that no representations of a *particular sort* have been made, some courts prevent a party from showing that the disclaimer is false.

Example: On the facts of the above example, suppose that the contract stated, "Seller has made no representations or warranties regarding the profitability of the property, and Buyer has relied solely on his own investigation as to profitability." Some courts – though probably a minority – would prohibit Buyer from showing that Seller in fact made fraudulent misrepresentations about profitability.

B. Existence of a condition: If the parties orally agree on a *condition* to the enforceability of the contract, or to the duty of one of them, but this condition is then not included in the writing, courts generally *allow proof* of this condition despite the parol evidence rule. [199 - 200]

Example: *A* and *B* agree that *A* will sell a patent to *B* for \$10,000 if *C*, an engineer advising *B*, approves. *A* and *B* sign a written agreement that seems to be complete, except that the contract does not mention *C*'s approval. Nearly all courts would allow *B* to prove that the oral agreement regarding approval was in fact made.

C. Collateral agreements: An oral agreement that is supported by *separate consideration* may be demonstrated, even though it occurred prior to what seems to be a total integration. [200]

Example: In a written agreement that seems to be a complete expression of the parties' intent, *A* promises to sell *B* a particular automobile. As part of the transaction, the parties orally agree that *B* may keep the car in *A*'s garage for one year for \$15 per month. Because the alleged oral agreement is supported by separate consideration – the \$15 per month – *B* may prove that the oral agreement

occurred even though there is an integrated writing that does not include that agreement.

D. Subsequent transactions: Recall that the parol evidence rule never bars evidence that *after the signing of the writing*, the parties orally or in writing agreed to modify or rescind the writing. [200]

V. INTERPRETATION

A. Modern view: Most courts today allow parties to introduce extrinsic evidence to aid in the *interpretation* of a contract, even if the writing is an integration. That is, parties are generally allowed to introduce evidence of *what they subjectively thought the terms in a writing meant*, even if the writing is an integration. [201 - 203]

B. Maxims of interpretation: There are a number of "maxims" that courts use in deciding which of two conflicting interpretations of a clause should be followed: [203]

1. Primary purpose: If the *"primary purpose"* of the parties in making the contract can be ascertained, that purpose is given great weight.

2. All terms made reasonable, lawful and effective: All terms will be interpreted, where possible, so that they will have a *reasonable, lawful* and *effective* meaning.

3. Construed against drafter: An ambiguous term will be *construed against the person who drafted the contract*.

4. Negotiated terms control standard terms: A term that has been *negotiated* between the parties will control over one that is part of a standardized portion of the agreement (i.e., the fine print "boilerplate"). (*Example:* A clause that has been typewritten in as a "rider" to a pre-printed form contract, or a clause that has been handwritten onto a typewritten, agreement, will have priority.)

VI. TRADE USAGE, COURSE OF PERFORMANCE, AND COURSE OF DEALING

A. Definitions: There are three special sources which are used in interpreting the terms of a contract. These are especially important in sales contracts, since the UCC gives these sources specific treatment: [204 - 206]

1. Course of performance: A *"course of performance"* refers to the way the parties have conducted themselves in performing the *particular contract at hand*. (*Example:* The contract calls for repeated deliveries of "highest grade oil." Evidence as to the quality of oil delivered and

accepted in the first installments would be admissible as a course of performance to help determine whether oil delivered in a later installment met the contract standard.)

2. Course of dealing: A "*course of dealing*" refers to how the parties have acted with respect to *past contracts*.

3. Usage of trade: 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." UCC § 1-205(2). Thus the meaning attached to a particular term in a certain region, or in a certain industry, would be admissible.

B. Used to interpret even a complete integration: Course of dealing, course of performance, and usage of trade may be introduced to help interpret the meaning of a writing *even if the writing is a complete integration*. That is, these sources are not affected by the parol evidence rule – even though a writing is found to be the final and exclusive embodiment of the agreement, it may still be explained by evidence from these three sources. [205 - 206]

1. Contradiction of express terms: But these customs may not be used to *contradict* the express terms of a contract. See UCC § 2-208(2). However, if these customs can reasonably be harmonized with the writing, then the customs may be shown and may become part of the contract.

C. Priorities: Where more than one of these types of customs is present, the *most specific pattern controls*. Thus an express contractual provision controls over a course of performance, which controls over a course of dealing, which controls over a trade usage. UCC §§ 2-208(2) and 1-205. [206]

VII. OMITTED TERMS SUPPLIED BY COURT

A. Generally: Courts will generally *supply a missing term* (that is, a term as to which the contract documents are silent) if it is apparent that the parties wanted to bind themselves, and there is a reasonable way for the court to go about formulating the missing term. Here are some examples: [206]

1. Good faith: The court will normally supply a term imposing on each party a "*duty of good faith*." (Example: Where *A* agrees to have exclusive marketing rights to a design or invention produced by *B*, *A* will be found to have an implied duty to make good faith efforts to promote *B*'s product.) [207]

2. Duty to continue business: In requirement and output contracts, generally there will *not* be a duty to *continue the business* (assuming the owner acted in good faith when she closed it down.) [207 - 208]

3. Termination of dealership or franchise: Some but not all courts will supply a term to prevent one party from arbitrarily terminating a *franchise* or *dealership* arrangement. Sometimes, the court will refuse to allow termination except for cause. More commonly, courts will find an implied requirement of a *reasonable notice* prior to termination. [208]

4. Termination of employment contract: A strong minority of courts now find that an *at-will employment contract* contains an implied term prohibiting the employer from terminating the arrangement in *bad faith*. In these courts, an employer may not terminate an at-will arrangement in order to deprive the employee of a pension, to retaliate for the employee's refusal to commit wrongdoing at the employer's urging, or for other bad faith reasons. [208 - 211]

CONDITIONS, BREACH AND OTHER ASPECTS OF PERFORMANCE

I. CONDITIONS GENERALLY

A. Definition of "condition": An event which must occur before a particular performance is due is called a "**condition**" of that performance. [215]

Example: Seller promises to ship Buyer 100 widgets. Buyer promises to pay for the widgets within 30 days of receipt. The parties agree that if the widgets don't meet Buyer's specs, he

may return them and he will not have to pay for them. It is a condition of Buyer's duty of payment that the widgets be shipped, and that they meet his specifications. Buyer's duty is said to be conditional on the shipment of satisfactory widgets.

1. Concurrent: A *concurrent* condition is a particular kind of condition precedent which exists only when the parties to a contract are to exchange performances at the *same time*. (*Example: A* promises to deliver his car to *B* on a certain date, at which time *B* is to pay for the car. Delivery and payment are "concurrent conditions," since performance by both is to be rendered simultaneously.) Concurrent conditions are found most frequently in contracts for the sale of goods and contracts for the conveyance of land.

2. Express and constructive conditions: If the parties explicitly agree that a duty is conditional upon the happening of some event, that event is an "*express*" condition. If, instead, the happening of an event is made a condition of a duty because a court so determines, the condition is a "*constructive*" one (or a condition "implied in law"). [217 - 218]

Example of express condition: *A* is to ship widgets to *B*, and *B* agrees to either return them if they don't satisfy her, or pay for them. The contract states, "*B*'s duty to pay for the widgets shall be conditional upon her being satisfied with them." This is an express condition.

Example of constructive condition: Same facts as above example – *A* contracts to ship widgets to *B*, and *B* agrees to either return the widgets as unsatisfactory, or pay for them. No language of condition is used in the agreement. As a matter of common law (or the UCC), the court will impose a constructive condition: *B*'s duty to pay for the widgets will be constructively conditioned upon her receiving them and being satisfied with them.

a. Significance of distinction: The reason we distinguish between express and constructive conditions is that *strict compliance* with

express conditions is ordinarily necessary, but merely *substantial compliance* is usually required to satisfy a constructive condition.

B. Distinction between conditions and promises: The fact that an act is a condition does not by itself make it also a promise. If the act is a condition on the other party's duty, and the act fails to occur, the other party won't have to perform. If the act is a promise, and it doesn't occur, the other party can sue for damages. But the two don't automatically go together. [218 - 220]

Example: Landlord promises Tenant that Landlord will make any necessary repairs on the leased premises, provided that Tenant gives him notice of the need for such repairs. Tenant's giving notice of the needed repairs is an express condition to Landlord's duty to perform the repairs. But such notice is not a promise by Tenant.

Therefore, if Tenant does not give the notice, he has not committed any breach of contract, but a condition to Landlord's duty has failed to occur. Landlord is relieved from having to make the repairs, but cannot sue Tenant for breach.

1. Distinguishing: To determine whether a particular act is a condition, a promise, or both, the main factor is the *intent of the parties*. Words like "upon condition that" indicate an intent that the act be a condition; words like "I promise" or "I warrant" indicate a promise (though as described below, failure to keep the promise will also generally constitute the failure of a constructive condition.)

II. EXPRESS CONDITIONS

A. Strict compliance: *Strict compliance* with an express condition is ordinarily required. [221 - 224]

Example: *A* contracts to sell his house to *B* for \$100,000. The contract provides that *B*'s duty to consummate the purchase is "conditional upon *B*'s receiving a mortgage for at least \$80,000 at an interest rate no higher than 9%." If the best mortgage *B* is able to obtain, after reasonable effort, is at 9.25%, the court will probably hold that *B* is not obligated to close, since the condition is an express one, and strict compliance with express conditions is ordinarily required.

1. Avoidance of forfeiture: However, courts often avoid applying the "strict compliance" rule where a *forfeiture* would result. A forfeiture occurs when one party has *relied* on the bargain (e.g., by preparing to perform or by making part performance), and insistence on strict compliance with the condition would cause him to fail to receive the expected benefits from the deal.

Example: *A* contracts to build a house for *B* on land owned by *B*, for a price of \$100,000. The contract provides that "*B*'s duty to pay for the house is expressly conditional upon the finished house exactly matching the specifications of *B*'s architect." *A* builds the house in general accordance with the specifications, but the living room is six inches shorter than shown on the plans, a deviation which does not noticeably affect the market value of the house.

Despite the rule that strict compliance with an express condition is ordinarily required, the court would probably hold that strict enforcement here would amount to a forfeiture, and would therefore hold that the condition was satisfied despite the trivial defect.

a. Excuse of condition: Alternatively, a court may find that the fulfillment of the express condition is "*excused*" where extreme forfeiture would occur. This will only be done, however, if the damage to the other party's expectations from non-occurrence of the condition is relatively *minor*. (*Example:* On the facts of the above example, the damage to *B*'s expectations from the short living room is very small, so the court would probably excuse the non-occurrence of the condition.)

B. Satisfaction of a party: If a contract makes one party's duty to perform expressly conditional on that party's being *satisfied* with the other's performance, the court will usually presume that an *objective* standard of "*reasonable*" satisfaction was meant. [224 - 225]

1. Subjective: But it is the *intent* of the parties that controls here: If the parties clearly intend that one party's *subjective* satisfaction should control, the court will honor that intent. This is likely to be true, for instance, where the bargain clearly involves the *tastes* of a person. Here, good-faith but unreasonable dissatisfaction will still count as the non-occurrence of the condition.

C. Satisfaction of third person: If the duty of performance is expressly conditioned on the satisfaction of some *independent third party* (e.g., an architect or other professional), the third party's subjective judgment usually controls. But this judgment must be made in good faith. [225]

III. CONSTRUCTIVE CONDITIONS

A. Use in bilateral conditions: Remember that a *constructive condition* is a condition which is not agreed upon by the parties, but which is supplied by the court for fairness. The principal use of constructive conditions is in bilateral contracts (where each party makes a promise to the other). [227 - 228]

1. General rule: Where each party makes one or more promises to the other, *each party's substantial performance of his promise is generally a constructive condition to the performance of any subsequent duties by the other party.*

Example: Contractor agrees to build a house for Owner for \$100,000. The contract provides that Owner will pay \$10,000 upon completion of the foundation, and provides a schedule on which the work is to proceed. No language of condition is used anywhere in the document. Contractor builds the foundation on schedule, but Owner without cause refuses to pay the \$10,000 charge.

Owner's fulfillment of his promise – to pay \$10,000 – is a constructive condition of Contractor's duty to continue with the work. Therefore, Contractor does not have to continue with the work until Owner pays the \$10,000, even though the contract does not expressly make Contractor's duty of continuation conditional upon Owner's making the first payment. The court simply supplies this "constructive condition" for fairness, reasoning that Contractor shouldn't have to keep doing work if Owner hasn't been keeping his part of the bargain.

B. Order of performance: Be careful to interpret the contract to determine the *order* in which the parties' performances are to occur. [228 - 232]

1. Intent: The parties' *intent* always controls. Where the intent is not clear, the court supplies certain presumptions, as discussed below.

2. Periodic alternating: The parties may agree that their performances shall *alternate*. This is true of most *installment* contracts. Here, a series of alternating constructive conditions arises: each party's obligation to perform his duty is constructively conditioned on the other's having performed the prior duty. It's therefore important to decide who was the *first* to fail to substantially perform, since that failure of substantial performance is the non-occurrence of a constructive condition of the other party's subsequent duty. [228 - 229]

3. No order of performance agreed upon: If the parties do not agree upon the order of performance, there are several general presumptions courts use: [230 - 231]

a. Only one party's work requires time: Where the performance of one party requires a *period of time*, and the other's does not, the performance requiring time must ordinarily occur first, and its performance is a constructive condition to the other party's performance. This applies to contracts for *services* – a party who is to perform work must usually *substantially complete* the work

before he may *receive payment* if the parties do not otherwise agree.

b. Sales of goods and land: If each party's promised performance can occur at the *same time* as the other's, the court will normally require that the two occur *simultaneously*, in which case the two performances are "concurrent conditions." This applies to *sales of goods and land*.

i. Tender of performance: Courts express this by saying that where the two performances are concurrent, each party must "*tender*" (i.e., *conditionally offer*) performance to the other. See UCC §§ 2-507(1) and 2-511(1).

Example: Seller contracts to sell Blackacre to Buyer. The closing is to take place on July 1, at which time Seller will deliver a deed to the property free and clear of liens, and Buyer will deliver a certified check for \$100,000. Since each performance can occur simultaneously, the court will presume that simultaneity is what the parties intended.

Therefore, on July 1, Seller's duty to deliver the deed will be conditional upon Buyer's coming forward with the certified check, and Buyer's duty to come forward with the check will be conditional upon Seller's tendering the deed. If Seller fails to show up with a proper deed, Buyer will not be able to sue Seller for breach unless Buyer shows that he tendered the certified check, i.e., had the check in his possession and arrived at the place of closing with it.

C. Independent or dependent promises: In the normal bilateral contract, the court will presume that the promises are *in exchange for each other*. That is, the court will treat the promises as being *mutually dependent*, so that each party's duty is constructively conditional upon the other's substantial performance of all previous duties. [232 - 233]

1. Independent promises: But in a few situations, circumstances may indicate that the promises are intended to be *independent* of each other. Here, the court will *not* apply the theory of constructive conditions.

a. Real estate leases: For instance, promises in the typical *real estate lease* are generally construed as being *independent* of each other. Thus a tenant's promise to pay rent, and a landlord's return-promise to make repairs, are treated as independent, so if the landlord does not make the repairs, the tenant cannot refuse to pay

the rent (though he can of course sue for damages). But a growing minority of courts have rejected this rule of independence.

D. Divisible contracts: A *divisible* contract is one in which both parties have divided up their performance into units or installments, in such a way that each part performance is roughly the compensation for a corresponding part performance by the other party. If a contract is found to be divisible, it will for purposes of constructive conditions be treated as a series of *separate contracts*. [233 - 236]

1. Significance: If the contract is found to be divisible, here's the significance: if one party partly performs, the other will have to make *part payment*. If the contract is not divisible, then the non-breaching party won't have to pay anything at all (at least under the contract).

Example: In a single document, Contractor agrees to build a deck for Owner and renovate Owner's kitchen. The contract lists a price of \$30,000 for the renovation and \$20,000 for the deck. Payment on the entire contract is due when all work is done. Contractor completes the deck but never even starts on the kitchen.

If the contract is found to be divisible into two parts, Owner will be required to pay \$20,000 for the deck even though he never gets the kitchen. If the contract is not divisible, Contractor will be found to not have substantially performed the whole, and he will not be able to recover on the contract for the work on the deck (though he will be able to recover the fair value of what he has done on a quasi-contract or restitution theory).

2. Test for divisibility: A contract is divisible if it can be "apportioned into corresponding pairs of part performances so that the parts of each pair are properly regarded as *agreed equivalents*." (Example: On the facts of the above example, a court would probably find that the parties implicitly agreed that \$20,000 would be an agreed equivalent for the deck and \$30,000 for the kitchen. Therefore, the court would probably find that the contract was divisible.) [233 - 236]

a. Employment contracts: Most *employment* contracts are looked on as being divisible. Usually, the contract will be divided into lengths of time equal to the *time between payments*. Thus if the employee is paid by the week, the contract will be divided into one-week "sub-contracts"; payment for a particular week will be constructively conditioned only on the employee's having worked that week, not on his having fulfilled the entire contract.

b. Fairness: The court will not find a contract to be divisible if this would be *unfair* to the non-breaching party. For instance, even though the contract recites separate prices for different part performances, requiring the non-breaching party to pay the full stated price for the part performance received may deprive him of fair value.

Example: A construction contract requires Owner to pay one-tenth of the contract price for each of 10 weeks of estimated work. The first week, Contractor does everything scheduled for that week, but the scheduling is very light, consisting mainly of site preparation. If Contractor breaches after the first week, the court will probably not find the contract divisible, since a finding of divisibility would require Owner to pay one-tenth of the contract price for performance that represents less than one-tenth of the full job.

IV. SUBSTANTIAL PERFORMANCE

A. Doctrine generally: Recall that it is a constructive condition to a party's duty of performance that the other party have made a "*substantial performance*" of the latter's previous obligations. In other words, if one party fails to substantially perform, the other party's remaining duties do not fall due. [238]

B. Suspension followed by discharge: If a party fails to substantially perform, but the defects could be fairly easily cured, the other party's duty to give a return performance is merely *suspended*; the defaulter then has a chance to *cure* his defective performance. If, on the other hand, the defect is so substantial that it cannot be cured within a reasonable time, or if the defaulter fails to take advantage of a chance to cure, the other party is then completely *discharged*, and may also sue for breach. [238]

C. Factors regarding materiality: Here are some factors that help determine whether a breach is material (i.e., whether the breaching party has nonetheless substantially performed): [239 - 241]

1. Deprivation of expected benefit: The more the non-breaching party is deprived of the *benefit which he reasonably expected*, the more likely it is that the breach was material. [239]

2. Part performance: The *greater the part of the performance* which has been rendered, the less likely it is that a breach will be deemed material. Thus a breach occurring at the very *beginning* of the contract is more likely to be deemed material than the same "size" breach coming near the end. [239]

3. Likelihood of cure: If the breaching party seems likely to be able and willing to *cure*, the breach is less likely to be material than where cure seems impossible. [240]

4. Willfulness: A *willful* (i.e., *intentional*) breach is more likely to be regarded as material than a breach caused by negligence or other factors. [240]

5. Delay: A delay, even a substantial one, will not necessarily constitute a lack of substantial performance. The presumption is that *time is not "of the essence"* unless the contract so states, or other circumstances make the need for promptness apparent. (Even if the contract *does* contain a "time is of the essence" clause, a short delay will not be deemed "material" unless the circumstances show that the delay seriously damaged the other party.) [240 - 241]

D. Material breach in contracts for the sale of goods: The UCC imposes special rules governing what constitutes substantial performance by a seller of goods (and thus when a buyer can reject the goods). [241 - 249]

1. "Perfect tender" rule: UCC § 2-601 says that as long as the contract does not involve installments (i.e., multiple deliveries), "Unless otherwise agreed ... if the goods or tender of delivery fail *in any respect* to conform to the contract, the buyer may (a) reject the whole; or (b) accept the whole; or (c) accept any commercial unit or units and reject the rest." On its face, this section seems to impose the "*perfect tender*" rule – that is, it seems to give the buyer the right to cancel the contract, and refuse to pay, if the goods deviate from the contract terms in any respect, no matter how slight. [241]

a. Not so strict: But in reality, there are loopholes in this "perfect tender" rule. Courts usually only allow buyers to reject the seller's delivery if the defect is a substantial one. Also, the buyer must follow strict procedures for rejecting the delivery, and the seller generally has the right to "cure" the defect. See below.

2. Mechanics of rejection: The buyer may "*reject*" any non-conforming delivery from the seller. As noted, in theory this right exists if the goods deviate *in any respect* from what is required under the contract. But the buyer's right of rejection is subject to some fairly strict procedural rules: [245 - 246]

a. Time: Rejection must occur within a "*reasonable time*" after the goods are delivered. The buyer must give prompt *notice* to the seller that buyer is rejecting. § 2-602(1).

b. Must not be preceded by acceptance: The buyer can only reject if he has not previously "accepted" the goods. He will be deemed to have "accepted" them if either: (1) after a reasonable opportunity to *inspect*, buyer has indicated to the seller that the goods are conforming or that he will keep them despite non-conformity; or (2) buyer fails to make a timely rejection (though this cannot happen until buyer has had a reasonable inspection opportunity); or (3) buyer does "any act inconsistent with the seller's ownership" (e.g., using the goods as part of a manufacturing process). See [§ 2-606\(1\)](#).

3. Revocation of acceptance: Even if the buyer has "accepted" the goods, if he then discovers a defect he may be able to *revoke* his acceptance. If he revokes, the result is the same as if he had never accepted – he can throw the goods back on the seller and refuse to pay. [246]

a. Revocation vs. rejection: The buyer who wants to revoke an acceptance must make a *stronger showing of non-conformity* than the buyer who rejects – the revoker must show that the non-conformity "substantially impairs" the value of the goods, whereas the rejecter must merely show that the goods fail to conform "in any respect." On the other hand, a buyer probably gets more time to revoke than to reject.

4. Cure: Both the buyer's right to reject and his right to revoke an acceptance are subject to the seller's right to *cure* the non-conformity. See [§ 2-508\(1\)](#). [247 - 248]

a. Beyond contract: Even *after* the time for performance under the contract has passed, the seller has a limited right to cure: he gets additional time to cure once the time for delivery under the contract has passed, if he *reasonably thought* that either: (1) the goods, though non-conforming, would be *acceptable* to the buyer; or (2) the buyer would be satisfied with a *money allowance*. See [UCC § 2-508\(2\)](#).

5. Installment contracts: The Code is more lenient to sellers under *installment* contracts (i.e., contracts calling for several deliveries) than in single delivery contracts. In the case of an installment contract, "the buyer may reject any installment which is non-conforming if the non-conformity *substantially impairs the value* of that installment and *cannot be cured...*" [§ 2-612\(2\)](#). So a slight non-conformity in one installment does not allow the buyer to reject it, as he could in a single-delivery contract. [245]

a. Cancellation of whole: The buyer has the right to cancel the *entire installment contract* if the defect is grave enough: cancellation of the whole is allowed if the defective installment "substantially impairs the value of the whole contract." § 2-612(3).

Example: Seller contracts to deliver a computer, as well as a customized disk drive to work in the computer. Buyer's application requires both parts to work successfully. Seller delivers a defective disk drive and fails to cure. Buyer can probably cancel the whole contract, since the defect in the disk drive substantially impairs the value of the whole contract, including the computer, to him.

V. EXCUSE OF CONDITIONS

A. Introduction: In some instances, the non-occurrence of a condition is "*excused*," so that the other party nonetheless must perform. [251]

B. Hindrance: Where one party's duty is conditional on an event, and that same party's wrongful conduct *prevents* the occurrence of the condition, the non-occurrence of the condition is excused, and the party must perform despite the non-occurrence. [251 - 253]

1. Implied promise of cooperation: Courts sometimes express this concept by saying that each party makes the other an "implied promise of cooperation." One consequence of a breach of this implied promise is that the non-occurrence of the condition to that party's duty is excused.

Example: P agrees to live with D, his grandmother, and to care for her for the rest of her life, in return for D's promise to leave P \$100,000 in D's will. P lives with D for seven years, at the end of which D unreasonably forces P to leave the house. Five years later, D dies. P will be able to recover the \$100,000, even though he did not live with D for the rest of her life. The reason is that the non-occurrence of the condition – caring for D for the rest of her life – was excused by D's failure to cooperate.

C. Waiver: A party who owes a conditional duty may indicate that he will *not insist* upon the occurrence of the condition before performing. A court will often take the party at his word, and enforce that party's willingness to forego the benefit of the condition. In this event, the party is said to have *waived* the condition. [253 - 257]

1. Minor conditions: Generally, the court is much more likely to find that the condition is waived if it is a *minor* one, such as a procedural or technical one. [255]

2. Continuation of performance: If a promisor *continues his own performance* after learning that a condition of duty has failed to occur, his conduct is likely to be found to operate as a waiver of the condition. [255]

Example: Insurer insures Owner's house for fire; Insurer's duty to pay a claim is expressly conditional upon notice by Owner within seven days of any fire. Owner gives notice three weeks after a fire. Insurer sends an adjuster, attempts to make a settlement, and otherwise behaves as if it is not insisting on strict compliance with the notice provision. This continuation of performance will probably be found to be a waiver of the timely-notice condition.

a. Right to damages not lost: When a party continues his own performance after breach, or otherwise waives a condition, he has *not* necessarily lost his right to recover *damages for breach* of the condition. [256]

VI. REPUDIATION AND PROSPECTIVE INABILITY TO PERFORM

A. General effect of prospective breach: If a party indicates that he will *subsequently* be unable or unwilling to perform, this will act as the non-occurrence of a constructive condition, in the same way as a present material breach does. In other words, the other party has the right to *suspend his own performance*. [260]

1. Distinction: Where the party indicates that he will *refuse* to perform, this is called an "*anticipatory repudiation*" of the contract. If he indicates that he would like to perform but will be unable to do so, this is an indication of "*prospective inability to perform*" but not repudiation; however, the consequence is still that the other party may suspend performance. [260]

B. Insolvency or financial inability: If a party is *insolvent* or otherwise financially incapable of performing, this will entitle the other party to stop performance.

1. Cancellation: If the prospective inability or unwillingness to perform is *certain* or almost certain, the other party can not only suspend her performance, but can actually *cancel* the contract. But where it is not so clear whether the first party will be unable or unwilling to perform, the other party may only *suspend* performance.

C. Right to adequate assurance of performance: If a party's conduct or words don't constitute an outright repudiation, but merely suggest that that party may not perform, the other party may *demand assurances* that the first party will

perform. If the first party fails to provide these assurances, this failure will itself be considered a repudiation, entitling the innocent party to cancel. [261 - 264]

1. UCC: Thus [UCC § 2-609\(1\)](#) provides that "when reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may, if commercially reasonable, suspend any performance for which he has not already received the agreed return." [261]

Example: Buyer places two orders (separate contracts) with Seller, one for shipment on July 1 and the other for shipment on September 1. Each shipment is to be paid for within 30 days. Seller ships the first order promptly, and by August 28 the bill is almost one month past due.

Seller may in writing demand assurances that Buyer will pay for both the first order and the second order in a timely fashion. If Buyer fails to respond, Seller may cancel the second contract, and sue for breach of both. But if Buyer furnishes reasonable assurances – as by demonstrating that non-payment of the first invoice was a clerical omission, and immediately rectifying it – Seller must reinstate the second contract.

ANTICIPATORY REPUDIATION AND OTHER ASPECTS OF BREACH

I. ANTICIPATORY REPUDIATION

A. General rule: If a party makes it clear, even before his performance is due, that he cannot or will not perform, he is said to have *anticipatorily repudiated* the contract. All states except Massachusetts allow the victim of such an anticipatory repudiation to *sue before the repudiator's time for performance has arrived*. This is sometimes called the rule of *Hochster v. De La Tour*. [271]

Example: Star promises Movie Co. that Star will act in Movie Co.'s movie, shooting for which is scheduled to commence in the U.S. on July 1. On June 1, Star announces to the press that he is going to live abroad for a year beginning the next day and will not do the movie. Under the rule of *Hochster v. De La Tour*, Movie Co. can sue Star for breach as soon as he issues his press statement; Movie Co. need not wait until July 1, the time at which Star's performance is due.

B. What constitutes repudiation: An anticipatory repudiation occurs whenever a party clearly indicates that he cannot or will not perform his contractual duty. [272 - 274]

1. Statement: Sometimes, the repudiation takes the form of a *statement* by the promisor that he intends not to perform. (The above example illustrates this.) But the fact that the promisor states *vague doubts* about his willingness or ability to perform is *not enough*. (Example: On facts of above example, Star says, "I'm feeling pretty exhausted, so I don't know if I'll be able to perform the role, but let's hope I'll feel well enough." This would probably not be an anticipatory repudiation, because it is equivocal.) [272 - 273]

2. Voluntary actions: The repudiation may occur by means of an *act* by the promisor that makes his performance impossible. (Example: Seller contracts to convey Blackacre to Buyer, the closing to take place on July 1. On June 15, Seller conveys Blackacre to X. This is an anticipatory repudiation by action, and Buyer may sue immediately, rather than waiting until July 1.) [273]

3. Prospective inability to perform: Something analogous to anticipatory repudiation occurs when it becomes evident that the promisor will be *unable* to perform, even though he desires to do so. When this occurs, all courts agree that the promisee may *suspend her performance*. But courts are split on whether the promisee may bring an immediate suit for breach, as she is allowed to do where the repudiation is a statement or a voluntary act. [273]

a. Insolvency: The promisor's *insolvency* usually is *not* considered to be the type of anticipatory repudiation that allows the other party to sue immediately for breach. But the promisee may request assurances of performance, and if the promisor can't give these (e.g., he can't show that he will become sufficiently solvent to perform), then an immediate suit for breach is allowed.

II. OTHER ASPECTS OF REPUDIATION

A. Repudiation after performance is due: Similar rules apply where a party's time for performance becomes due, and the party then repudiates (i.e., he indicates by word or deed that he cannot or will not perform). Here, even though the repudiation is not "anticipatory," the other party may cancel the contract and bring an immediate suit for breach, just as in the anticipatory situation. [275]

B. Retraction of repudiation: A repudiation (whether anticipatory or occurring after the time for performance) may normally be *retracted* until some event occurs to make the repudiation final.

1. Final acts: In most courts, the repudiator's time to retract *ends* as soon as the other party: (1) *sues* for breach; (2) *changes her position* materially in *reliance* on the repudiation; or (3) states that she *regards the repudiation as final*. See [UCC § 2-611\(1\)](#). [276]

C. Mitigation required: After a repudiation occurs, the repudiatee may *not* simply ignore the repudiation and continue the contract, if this would aggravate her damages. That is, the repudiatee must *mitigate her damages* by securing an alternative contract, if one is reasonably available. If she does not do this, she cannot recover the damages that could have been avoided. [276 - 277]

1. UCC: The UCC, in [§ 2-610\(a\)](#), expresses this mitigation requirement by saying that the repudiatee may "for a *commercially reasonable time* await performance by the repudiating party...."

D. Repudiation ignored, then sued on: Most courts hold that the repudiatee may *insist on performance*, at least for a while, rather than canceling the contract. Then, if the repudiator fails to retract the repudiation, the repudiatee may sue without being held to have waived any rights. [277]

E. Unilateral obligation to pay money: If the repudiatee *does not owe any performance* at the time of the repudiation, he is generally *not* permitted to bring an immediate suit for anticipatory repudiation; instead, he must wait until the time for the other party's performance is due. The reason is that the ordinary rule allowing immediate suit is designed to give the innocent party a chance to avoid having to render his own performance; where the innocent party does not owe any performance, the rationale does not apply. [278 - 279]

1. Payment of money: This exception means that an anticipatory repudiation of an unconditional unilateral obligation to *pay money* at a fixed time does not give rise to a claim for breach until that time has arrived.

Example: The tycoon Donald Tramp contracts to repay to Bank a \$100 million loan, repayment to occur July 1. On June 1, Tramp declares publicly, "I won't be paying Bank back on July 1. Let 'em sue me." Because Bank does not owe any further performance under the contract (it's already made the loan), Bank may *not* sue Tramp until July 1 arrives and the payment is not made.

2. Installments: This also means that if a debtor fails to pay a particular *installment* of a debt, and says that he will not make later payments, the creditor cannot bring suit for those later installments until they fall due. But lenders ordinarily avoid this problem by inserting an "*acceleration clause*" into the loan agreement, by which failure to pay one installment in a timely manner causes all later installments to become immediately due; such acceleration clauses are enforceable.

F. UCC damages for repudiation: Pay special attention to damages suffered by a *buyer* under a contract for the sale of goods, where the seller has anticipatorily repudiated the contract. UCC § 2-713(1) says that "the measure of damages for...repudiation by the seller is the difference between the market price *at the time when the buyer learned of the breach* and the contract price, together with any incidental and consequential damages." [279 - 280]

1. Meaning: The phrase "time when the buyer learned of the breach" is ambiguous. Most courts hold that this phrase means "time when the buyer *learned of the repudiation.*"

Chapter 9
STATUTE OF FRAUDS

I. INTRODUCTION

A. Nature of Statute of Frauds: Most contracts are valid despite the fact that they are only oral. A few types of contracts, however, are *unenforceable* unless they are *in writing*. Contracts that are unenforceable unless in writing are said to fall "within the Statute of Frauds." The Statute of Frauds is pretty much identical from state to state. [284 - 285]

B. Five categories: There are five categories of contracts which, in almost every state, fall with the Statute of Frauds and must therefore be in writing: [285]

1. **Suretyship:** A contract to answer for the *debt* or duty of *another*.
2. **Marriage:** A contract made upon *consideration of marriage*.
3. **Land contract:** A contract for the *sale of an interest in land*.
4. **One year:** A contract that cannot be performed within *one year* from its making.
5. **UCC:** Under the UCC, a contract for the sale of *goods* for a price of *\$500* or more.

II. SURETYSHIP

A. General rule: A promise to pay the *debt* or duty of *another* is within the Statute of Frauds, and is therefore unenforceable unless in writing. [285 - 289]

B. Main purpose rule: If the promisor's chief purpose in making his promise of suretyship is to further *his own interest*, his promise does *not* fall within the Statute of Frauds. This is called the "*main purpose*" rule. [289 - 290]

Example: Contractor contracts to build a house for Owner. In order to obtain the necessary supplies, Contractor seeks to procure them on credit from Supplier. Supplier is unwilling to look solely to Contractor's credit. Owner, in order to get the house built, orally promises Supplier that if Contractor does not pay the bill, Owner will make good on it. Because Owner's main purpose in giving the guarantee is to further his own economic interest – getting the house built – his promise does *not* fall within the suretyship provision, and is therefore not required to meet the Statute of Frauds. So it is enforceable even though oral.

III. THE MARRIAGE PROVISION

A. Contract made upon consideration of marriage: A promise for which the consideration is *marriage* or a promise of marriage is within the Statute. [291 - 292]

Example: Tycoon says to Starlet, his girlfriend, "If you will promise to marry me, I'll transfer to you title to my Malibu beach home even before our marriage." Starlet replies, "It's a deal." No document is signed. If Tycoon changes his mind, Starlet cannot sue to enforce either the promise of marriage or the promise to convey the beach house, since the consideration for both of these promises was her return promise to marry Tycoon. Conversely, if Starlet changes her mind, Tycoon cannot sue for breach either.

1. Exception for mutual promises to marry: But if an oral contract consists *solely of mutual promises to marry* (with no ancillary promises regarding property transfers), the contract is *not* within the Statute of Frauds, and is enforceable even though oral. That is, *an ordinary oral engagement is an enforceable contract*.

IV. THE LAND CONTRACT PROVISION

A. Generally: A promise to transfer or buy *any interest in land* is within the Statute. The Statute does not apply to the conveyance itself (which is governed by separate statutes everywhere) but rather to a *contract providing for* the subsequent conveyance of land. [292 - 294]

Example: O, the owner of Blackacre, orally promises to convey it to A in return for A's payment of \$100,000. If A fails to come up with the \$100,000 by closing date, O cannot sue for breach. Conversely, if O refuses to make the conveyance even though A tenders the money, A cannot sue O for breach.

1. Interests in land: The Statute applies to promises to transfer not only a fee simple interest in land, but to transfer most other kinds of interests in land. [292 - 293]

a. Leases: For instance, a *lease* is generally an "interest in land," so that a promise to make a lease will generally be unenforceable if not in writing.

i. One year or less: But most states have statutes making oral leases enforceable if their duration is *one year or less*.

b. Mortgages: A promise to give a *mortgage* on real property as security for a loan also usually comes within the Statute.

c. Contracts incidentally related to land: But contracts that relate only *incidentally* to land are not within the Statute. Thus a contract

to **build a building** is not within the Statute, nor is a promise to lend money with which the borrower will buy land.

B. Part performance: Even if an oral contract for the transfer of an interest in land is not enforceable at the time it is made, subsequent **acts** by either party may make it enforceable. [293 - 294]

1. Conveyance by vendor: First, if the vendor under an oral land contract makes the contracted-for conveyance, he may recover the contract price.

2. Vendee's part performance: Second, the vendee under an oral land contract may in reliance on the contract take actions which: (1) show that the oral contract was really made; and (2) also create a **reliance interest** on the part of the vendee in enforcement. Such a vendee may then obtain **specific performance** (a court order that the vendor must convey the land) even though the contract was originally unenforceable because oral.

a. Taking possession and making improvements: For instance, if the vendee pays some or all of the purchase price, moves onto the property, and then makes **costly improvements** on it, this combination of facts will probably induce the court to grant a decree of specific performance.

b. Payment not sufficient: Usually, the fact that the vendee has paid the vendor the purchase price under the oral agreement is **not by itself sufficient** to make the contract enforceable. (Instead, the vendee can simply recover the purchase price in a non-contract action for restitution.)

V. THE ONE-YEAR PROVISION

A. General rule: If a promise contained in a contract is **incapable of being fully performed within one year** after the making of the contract, the contract must be in writing. [296]

1. Time runs from making: The one-year period is measured from the **time of execution of the contract**, not the time it will take the parties to perform. (*Example:* On July 1, 1990, Star promises Network that Star will appear on a one-hour show that will take place in September, 1991. This contract will be unenforceable if oral, because it cannot be performed within one year of the day it was made. The fact that actual performance will take only one hour is irrelevant.)

B. Impossibility: The one-year provision applies only if complete performance is **impossible** within one year after the making of the contract. The fact that performance within one year is highly unlikely is not enough. [296 - 298]

1. Judge from time of contract's execution: The possibility of performing the contract within one year must be judged *as of the time the contract is made*, not by benefit of hindsight.

Example: O orally promises A that O will pay A \$10,000 if and when A's husband dies. A's husband does not die until four years after the promise. The promise is nonetheless enforceable, because viewed as of the moment the promise was made, it was possible that it could be completed within one year – the fact that it ended up not being performed within one year is irrelevant.

C. Impossibility or other excuse: It is only the possibility of "*performance*," not the possibility of "*discharge*," that takes a contract out of the one-year provision. Thus the fact that the contract might be discharged by *impossibility*, *frustration*, or some other excuse for non-performance will not take the contract out of the Statute. [297 - 298]

1. Fulfillment of principal purpose: It will often be hard to tell whether a certain kind of possible termination is by performance or by discharge. The test is whether, if the termination in question occurs, the contract has *fulfilled its principal purpose*. If it has fulfilled this purpose, there has been performance; if it has not, there has not been performance. Using this rule gives these results:

a. Personal service contract for multiple years: A *personal services contract* for more than one year falls within the one-year rule (and is thus unenforceable unless in writing) even though the contract would terminate if the employee died. The reason is that when the employee dies, the contract has merely been "discharged", not performed.

b. Lifetime employment: A promise to employ someone for his *lifetime* is probably *not* within the one-year provision, since if the employee dies, the essential purpose of guaranteeing him a job forever has been satisfied. So an oral promise of a lifetime job is probably enforceable.

c. Non-compete: A promise by a seller of a business *not to compete* with the buyer for a period longer than a year is *not* within the one-year provision, since if the seller dies within a year, the buyer has received the equivalent of full performance (he knows the seller won't be competing with him).

D. Termination: Courts are *split* about whether the existence of a *termination clause* that permits termination in less than a year will remove a more-than-one-year contract from the one-year provision. [298]

Example: Boss orally hires Worker to work for three years. Their oral agreement allows either party to cancel on 60 days notice. Courts are split on whether this contract is within the one-year agreement and must therefore be in writing. The Second Restatement seems to say that the giving of 60 days notice would be a form of "performance," so that this contract will be enforceable even though oral – Worker might give notice after one month on the job, in which case the contract would have been "performed" within three months of its making, less than one year.

E. Full performance on one side: Most courts hold that *full performance* by *one party* removes the contract from the one-year provision. This is true even if it actually takes that party more than one year to perform. [299]

F. Applies to all contracts: The rule that a contract incapable of performance within one year must satisfy the Statute applies to *all* contracts (including those that just miss falling within some other Statute of Frauds provision). For instance, even though the special UCC sale-of-goods statute (discussed below) requires a writing only where goods are to be sold for more than \$500, a contract to sell goods for \$300, to be delivered 18 months after the contract is made, must be in writing. [299]

VI. CONTRACTS FOR THE SALE OF GOODS

A. General rule: UCC § 2-201(1) says that "a contract for the sale of goods for the price of *\$500 or more* is not enforceable ... unless there is some writing sufficient to indicate that a contract for sale has been made...." So an oral contract for goods at a price of \$500 or more is unenforceable under the UCC. [301 - 302]

B. Exceptions: Even if a sales contract is for more than \$500, it is *exempted* from the Statute of Frauds requirement in three situations: [301 - 302]

1. Specially manufactured goods: No writing is required if the goods are to be *specially manufactured* for the buyer, are not suitable for sale to others, and the seller has made "either a substantial beginning of their manufacture or commitments for their procurement." § 2-201(3)(a).

2. Estoppel: A writing is also not required "if the party against whom enforcement is sought *admits* in his pleading, 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." § 2-201(3)(b).

3. Goods accepted or paid for: Finally, no writing is required "with respect to goods for which *payment has been made* and accepted or which have been *received and accepted*." § 2-201(3)(c). (*Example:* Buyer orally orders three pairs of shoes from Seller for a total of \$600. Buyer then

sends a check for this amount in advance payment. Once Seller takes the check and deposits it in the bank, Seller loses his Statute of Frauds defense.)

VII. SATISFACTION BY A MEMORANDUM

A. General requirements for: Even if there is no signed "contract," a signed "*memorandum*" summarizing the agreement may be enough to meet the Statute of Frauds. A memorandum satisfies the Statute if it: (1) reasonably *identifies* the subject matter; (2) indicates that a contract has been made between the parties; (3) states with reasonable certainty the *essential terms* of the contract; and (4) is *signed* "by or on behalf of the *party to be charged*." [304 - 307]

B. Signature: Because of the requirement of a signature "by the *party to be charged*," some contracts will be enforceable against one party, but not against the other. [305]

Example: Buyer orally agrees to buy Owner's house for \$200,000. Buyer then sends a document marked "confirmation," which states, "This confirms our agreement whereby I will buy your house for \$200,000. [signed, Buyer]" Owner can enforce the agreement against Buyer, but Buyer cannot enforce it against Owner, since only Buyer has signed the memorandum.

C. UCC: Under the UCC, a writing satisfies the Statute if it is "sufficient to indicate that a contract for sale has been made between the parties and [is] signed by the party against whom enforcement is sought...." § 2-201(2). [305 - 307]

1. Omissions: Even if the writing contains a *mistake* as to a term, there will often be enough to satisfy the Statute, under the UCC. For instance, a mistake on *price* or quantity, or even description of the item, will not be fatal (but plaintiff may only recover for the quantity actually stated in the memorandum). Contrast this with non-UCC cases, where a major mistake is likely to invalidate the memorandum.

2. Confirmation: Under the UCC, there is one situation in which a memorandum will be enforceable even against a party who does *not* sign it: if the deal is *between merchants*, one merchant who receives a signed *confirmation* from the other party will generally be bound, unless the recipient *objects* within 10 days after receiving the confirmation.

Example: Buyer and Seller are both merchants (i.e., they deal in goods of the kind in question). Buyer telephones Seller to order 1,000 widgets at \$10 apiece. Immediately after receiving the order, Seller sends a written confirmation, correctly listing the quantity and price. Assume that this confirmation constitutes a memorandum which would be enforceable by

Buyer against Seller. Unless Buyer objects in writing within 10 days after receiving the memo, he will be bound by it, just as if he had signed it.

VIII. ORAL RESCISSION AND MODIFICATION

A. Oral rescission: Where a contract is in writing, it can be *orally rescinded* (i.e., orally cancelled) even though the original was required to be in writing because of the Statute. That is, a rescission does not have to satisfy the Statute of Frauds, in non-UCC cases. Generally, this is true even if the original written agreement contains a "no oral modifications or rescissions" clause. [309]

1. Sale of goods: But a contract for the sale of *goods* can alter this result. "A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded..." § 2-209(2). (But even where such a "no oral modifications or rescissions" clause is present, if one party *relies* to his detriment on an oral rescission, this will probably be binding as a "waiver" of the other party's right to rely on the no-oral-rescissions clause.) [309]

B. Modification: Application of the Statute of Frauds to oral *modifications* is trickier.

1. General rule: Generally, to determine whether an oral modification of an existing contract is effective, *the contract as modified must be treated as if it were an original contract*. This is true whether the original contract is oral or written. [309]

a. Consequence: If the modifications are unenforceable under this test, *the original contract is left standing*. That is, the modification is treated as if it never occurred.

2. Reliance on oral modification: But if either party *materially changes his position in reliance* on an oral modification, the court may enforce the modification despite the Statute.

3. Modification of contracts under UCC: Contracts under the UCC work pretty much the same way: if the contract *as modified* would (if it were an original contract) have to meet the Statute of Frauds, the modification must be in writing. Also, a written "no oral modifications" clause is generally effective, just as is a "no oral rescissions" clause. [310]

IX. RESTITUTION, RELIANCE AND ESTOPPEL

A. Quasi-contractual recovery: A plaintiff who has rendered *part performance* under an oral agreement falling within the Statute of Frauds may recover in *quasi-contract* for the *value of benefits* he has conferred upon the defendant.

Example: Landlord orally agrees to rent Blackacre to Tenant for two years, at a rent of \$1,000 per month. After Tenant has occupied the premises for two months, Tenant moves out. Even though the agreement is unenforceable because it is for an interest in land and must therefore be in writing, Landlord can recover the reasonable value of Tenant's two-month occupancy.

1. Not limited by contract price: The plaintiff's quasi-contract recovery is *not limited* to the *pro-rata contract price*, in most courts. (*Example:* On the facts of the above example, if Landlord can show that the fair market value of a lease for Blackacre is \$2,000 a month, he may recover this amount times two months, even though the pro-rata lease amount is only \$1,000 per month.)

B. Promissory estoppel: Instead of a quasi-contract suit (which will generally protect only the plaintiff's restitution or reliance interest), a plaintiff who has relied on a contract that is unenforceable due to non-compliance with the Statute of Frauds may instead use the doctrine of *promissory estoppel*. Where one party to an oral agreement foreseeably and reasonably *relies to his detriment* on the existence of the agreement, the court may enforce the agreement notwithstanding the Statute, if this is the only way to avoid injustice. [311 - 313]

Example: P works for an established company, and has good job security. He orally accepts a two-year oral employment agreement with D, another company. By leaving his present employer, P loses valuable pension and other rights. Once P leaves the old employer to take the job with D, a court may well apply promissory estoppel to hold that the P-D agreement is enforceable notwithstanding non-compliance with the Statute of Frauds, since injustice cannot be otherwise prevented.

1. Misrepresentation regarding Statute: Courts are especially likely to apply promissory estoppel where the defendant has intentionally and falsely told the plaintiff that the contract is *not* within the Statute, or that a writing will subsequently be executed, or that the defense of the Statute will not be used. [311 - 312]

2. UCC: Courts are split about whether promissory estoppel may be a substitute for the Statute of Frauds in a *UCC context*. [313]

3. Degree of injury and unjust enrichment: The more grievously the plaintiff is injured (or the more extensively the defendant is unjustly enriched) by application of the Statute, the more likely the court is to allow promissory estoppel to be a substitute for compliance with the Statute. [313]

Chapter 10 REMEDIES

I. INTRODUCTION

A. Distinction: Distinguish between a suit brought *on the contract*, and a suit brought off the contract, i.e., in *quasi-contract*. [320]

1. Suit on the contract: Where the parties have formed a legally enforceable contract, and the defendant (but not the plaintiff) has breached the contract, the plaintiff will normally sue "*on the contract*." That is, he will bring a suit for breach of contract, and the court will look to the contract to determine whether there has indeed been a breach, and for help in calculating damages.

2. Quasi-contract: But in other circumstances, the plaintiff will bring a suit in "*quasi-contract*." Here, the plaintiff is not really asking for enforcement of the contract; instead, she is usually asking for damages based on the actual value of his performance, irrespective of any price set out in the contract. Situations where a quasi-contract recovery may be available include:

- a. Where the contract is unenforceably *vague*;
- b. Where the contract is *illegal*;
- c. Where the parties are discharged because of *impossibility* or frustration of purpose;
- d. Where plaintiff has herself *materially breached* the contract.

II. EQUITABLE REMEDIES

A. Two types: Sometimes the court will award "*equitable remedies*" instead of the usual remedy of money damages. There are two types of equitable relief relevant to contract cases: (1) *specific performance*; and (2) *injunctions*. [321 - 326]

1. Specific performance: A decree for *specific performance* orders the promisor to *render the promised performance*. (Example: A contracts to sell Blackacre to B on a stated date for a stated price. A then wrongfully refuses to make the conveyance. A court will probably award specific performance. That is, it will order A to make the conveyance.)

2. Injunction: An *injunction* directs a party to *refrain* from doing a particular act. It is especially common in cases where the defendant is

sued by his former employer and charged with breaching an employment contract by working for a competitor.

Example: D signs a contract with P, his employer, providing that D will not work for any competitor in the same city for one year after termination. D then quits and immediately goes to work for a competitor. If P sues on the non-compete, a court will probably enjoin D from working for the competitor for the year.

B. Limitations on equitable remedies: There are three important limits on the willingness of the court to issue either a decree of specific performance or an injunction: [322 - 324]

1. Inadequacy of damages: Equitable relief for breach of contract will not be granted unless *damages are not adequate to protect the injured party*. Two reasons why damages might not be adequate in a contracts case are: (1) because the injury cannot be estimated with sufficient certainty; or (2) because money cannot purchase a substitute for the contracted-for performance. (*Example of (2):* Each piece of land is deemed "unique", so an award of damages for breach by the vendor in a land sale contract will not be adequate, and specific performance will be decreed). [322 - 324]

2. Definiteness: The court will not give equitable relief unless the contract's terms are *definite enough* to enable the court to frame an adequate order. [323]

3. Difficulty of enforcement: Finally, the court will not grant equitable relief where there are likely to be significant difficulties in *enforcing and supervising* the order. (*Example:* Courts usually will not grant specific performance of a personal service contract, because the court thinks it will not be able to supervise defendant's performance to determine whether it satisfies the contract.) [323 - 324]

C. Land-sale contracts: The most common situation for specific performance is where defendant breaches a contract under which he is to convey a particular *piece of land* to the plaintiff. [324]

1. Breach by buyer: Courts also often grant specific performance of a land-sale contract where the seller has not yet conveyed, and it is the *buyer who breaches*. (*Example:* A contracts to sell Blackacre to B. If A fails to convey, a court will order him to do so in return for the purchase price. If B fails to come up with the purchase price, the court will order him to pay that price and will then give him title.)

D. Personal services contracts: [324]

1. No specific performance: Courts almost *never* order specific performance of a contract for *personal services*. This is true on both sides: the court will not order the employer to resume the employment, nor will it order the employee to perform the services.

2. Injunction: But where the employee under an employment contract breaches, the court may be willing to grant an *injunction* preventing him from working for a competitor. The employer must show that: (1) the employee's services are *unique* or *extraordinary*; and (2) the likely result will not be to leave the employee without other *reasonable means of making a living*.

E. Sale of goods: Specific performance will sometimes be granted in contracts involving the *sale of goods*. This is especially likely in the case of *output* and *requirements* contracts, where the item is not in ready supply. [326]

Example: P, a utility, contracts with D, a pipeline company, for D to supply all of P's requirements for natural gas for 10 years at a stated price. In a time of tight energy supplies, a court is likely to find that damages are not adequate to redress D's breach, because no other vendor will enter a similar fixed-price, long-term contract; therefore, the court will probably grant a decree of specific performance ordering D to continue with the contract.

III. VARIOUS DAMAGE MEASURES

A. Three types: There are three distinct kinds of interests on the part of a disappointed contracting party which may be protected by courts: [327]

1. Expectation: In most breach of contract cases, the plaintiff will seek, and receive, protection for her *"expectation interest."* Here, the court attempts to *put the plaintiff in the position he would have been in had the contract been performed*. In other words, the plaintiff is given the *"benefit of her bargain,"* including any *profits* she would have made from the contract.

2. Reliance: Sometimes the plaintiff receives protection for his *reliance interest*. Here, the court puts the plaintiff in *as good a position as he was in before the contract was made*. To do this, the court usually awards the plaintiff his *out-of-pocket* costs incurred in the performance he has already rendered (including preparation to perform). When reliance is protected, the plaintiff does not recover any part of the profits he would have made on the contract had it been completed.

a. When used: The reliance interest is used mainly: (1) when it is impossible to *measure* the plaintiff's expectation interest accurately (e.g., when profits from a new business which the

plaintiff would have been able to operate cannot be computed accurately); and (2) when the plaintiff recovers on a *promissory estoppel* theory.

3. Restitution: Finally, courts sometimes protect the plaintiff's "*restitution interest*." That is, the court forces the defendant to pay the plaintiff an amount equal to the *benefit which the defendant has received* from the plaintiff's performance. Restitution is designed to prevent unjust enrichment.

a. When used: The restitution measure is most commonly used where: (1) a non-breaching plaintiff has partly performed, and the restitution measure is greater than the contract price; and (2) a breaching plaintiff has not substantially performed, but is allowed to recover the benefit of what he has conferred on the defendant.

Note: In contract actions, all three of these measures are used at least some of the time. In quasi-contract actions, expectation damages are almost never awarded, but reliance and restitution damages frequently are. (For instance, reliance damages are often used in promissory estoppel cases where the suit is really in quasi-contract, and restitution is used by materially-breaching plaintiffs who are in effect suing in quasi-contract.)

IV. EXPECTATION DAMAGES

A. Defined: Expectation damages are the usual measure of damages for breach of contract. The court tries to *put the plaintiff in the position he would have been in had the contract been performed by the defendant*. The plaintiff should end up with a sum equal to the *profit* he would have made had the contract been completed. [328 - 329]

Example: P holds the copyright for a novel and publishes it in hardback. It grants D the exclusive right to publish the paperback edition, but "not sooner than October 1985." D ships the paperback edition to stores in September 1985 and paperback sales soar, eroding the sale of the hardback edition. P is entitled to expectation damages equal to the difference between the profit it did make in September 1985 and the profit it would have made had D not shipped the paperback edition one month too early. [*U.S. Naval Institute v. Charter Communications, Inc.*]

B. Formula for calculating: P's expectation damages are equal to the value of D's promised performance (generally the *contract price*), minus whatever benefits P has received from *not having to complete* his own performance. [329 - 332]

Example: Contractor agrees to build a house for Owner for \$30,000. The contract says that after Contractor has done half the work, he shall receive \$15,000. Contractor does half the work, and demands payment. Owner wrongfully refuses. At this point, assume that it would cost Contractor \$10,000 to complete the house (for materials, labor, etc.). Contractor's expectation damages are equal to the contract price (\$30,000), minus what would have been Contractor's cost of completion (\$10,000). Thus Contractor will recover \$20,000.

1. Overhead: The plaintiff's cost of completion (the amount he has saved by not having to finish) does *not* include any part of his *overhead*. [329]

2. Cost of completion or decrease in value: Where defendant has defectively performed, plaintiff normally can recover the *cost of remedying* defendant's defective performance. But if the cost of remedying defects is *clearly disproportionate* to the *loss in market value* from the defective performance, plaintiff will only recover the loss in market value. [329 - 330]

a. Economic waste: This principle is often applied where the defect is minor, and remedying it would involve "*economic waste*," such as the *destruction of what has already been done*. [330 - 331]

Example: Contractor contracts to build a house for Owner, with Reading pipe to be used. After the house is completely built, it is discovered that Contractor used Cohoes pipe rather than Reading pipe; the two are of virtually the same quality. Owner will be allowed to recover (or to subtract from the unpaid contract balance) only the difference in value between the two pipes (a negligible sum), not the much greater cost of ripping out the walls and all of the existing piping to make the replacement. [*Jacob & Youngs v. Kent*]

C. "Reasonable certainty": The plaintiff may only recover for losses which he establishes with "*reasonable certainty*." Mainly, this means that a plaintiff who claims that he would have *made profits* had the defendant not breached must show not only that there would have been profits, but also the likely *amount* of those profits. [332 - 334]

1. Profits from a new business: Courts are especially reluctant to award lost profits from a *new business*, that is, a business which at the time of breach was not yet in actual operation. [332 - 333]

2. Cost of completion unknown: Also, the "reasonable certainty" requirement may fail to be met where the plaintiff cannot show accurately enough what his *cost of completion* would have been. [333]

Example: Contractor contracts to build a house for Owner for \$100,000. After Contractor has done about half the work, Owner repudiates. If Contractor cannot demonstrate what his cost of completion would have been, he will be unable to recover expectation damages, and will have to be content with either reliance or restitution damages.

V. RELIANCE DAMAGES

A. Generally: *Reliance* damages are the damages needed to put the plaintiff in the *position he would have been in had the contract never been made*. Therefore, these damages usually equal the amount the plaintiff has *spent* in performing or in preparing to perform. They are used either where there is a contract but expectation damages cannot be accurately calculated, or where there is no contract but some relief is justifiable. The main situations where reliance damages are awarded are: [335 - 337]

1. Profit too speculative: Where expectation damages cannot be computed because plaintiff's *lost profits* are too speculative or uncertain. (For instance, where defendant's breach prevents plaintiff from developing a new business, profits are probably too speculative to be computed.) [336]

2. Vendee in land contract: Where the plaintiff is the *vendee* under a *land contract*, and the defendant fails to convey. Some states do not allow expectation damages in this situation, so plaintiff can recover his reliance damages (e.g., the down payment, plus any expenses reasonably incurred.) [336]

3. Promissory estoppel: Where plaintiff successfully brings an action based on *promissory estoppel*. Here, the suit is usually not truly on the contract, but is rather in quasi-contract. The court is trying to reduce injustice, so it gives plaintiff a "half-way" measure, less than expectation damages, but better than nothing. [337]

B. Limits on amount of reliance recovery: The plaintiff's reliance damages are sometimes *limited* to a sum smaller than the actual expenditures: [338]

1. Contract price as limit: Where D's only obligation under the contract is to pay a sum of money (the contract price), reliance damages will almost always be *limited to this contract price*. [338]

2. Recovery limited to profits: Also, most courts do *not* allow reliance damages to *exceed expectation damages*. However, the defendant has to bear the *burden of proving* what plaintiff's profit or loss would have been. [338]

a. Subtract amount of loss: Another way to express this idea is that there will be *subtracted* from plaintiff's reliance recovery the amount of the *loss* which defendant shows plaintiff would have suffered had the contract been performed.

3. Expenditures prior to signing: The plaintiff will not normally be permitted to recover as reliance damages expenditures made *before the contract was signed*, since these expenditures were not made "in reliance on" the contract. [339]

C. Cost to plaintiff, not value to defendant: When reliance damages are awarded, they are usually calculated according to the *cost to the plaintiff* of his performance, not the value to the defendant. [339]

VI. RESTITUTION

A. Generally: The plaintiff's restitution interest is defined as the *value to the defendant of the plaintiff's performance*. Restitution's goal is to *prevent unjust enrichment*. [340]

1. When used: The main uses of the restitution measure are as follows: (1) a non-breaching plaintiff who has partly performed before the other party breached may bring suit on the contract, and not be limited by the contract price (as she would be for the expectation and reliance measures); and (2) a breaching plaintiff who has not substantially performed may bring a quasi-contract suit and recover the value that she has conferred upon the defendant. [340 - 341]

2. Market value: Restitution is based on the *value rendered to the defendant*, regardless of how much the conferring of that value costs the plaintiff and regardless of how much the plaintiff was injured by the defendant's breach. This value is usually the sum which the defendant would *have to pay to acquire the plaintiff's performance*, not the subjective value to the defendant.

B. Not limited to the contract price: The main use of the restitution measure is that, in most courts, *it is not limited by the contract price*. If the work done by P prior to D's breach has already enriched D in an amount greater than the contract price, this entire enrichment may be recovered by P. This makes restitution sometimes very attractive, compared with both reliance and expectation measures. [341]

Example: Contractor agrees to build a house for Owner for \$100,000. After Contractor has done 90% of the work, Owner repudiates. At trial, Contractor shows that Owner can now resell the mostly-built house for \$120,000, not counting land. Contractor will be permitted to recover the whole \$120,000 on a

restitution theory, even though this sum is greater than the contract price (and thus greater than the expectation damages would be), and greater than the reliance measure (actual expenditures by Contractor).

1. Not available where plaintiff has fully performed: If at the time of D's breach, P has *fully performed* the contract (and D only owes money, not some other kind of performance) most courts do *not allow P to recover restitution damages*. [341]

C. Losing contract: Restitution may even be awarded where P has partly performed, and *would have lost money* had the contract been completed. [342] (*Example:* On the facts of the above example, assume that Contractor would have lost \$10,000 had the contract been fulfilled. Contractor may use the restitution measure to collect \$120,000, thus turning a \$10,000 loss into a \$10,000 profit.)

VII. SUBSTANTIAL PERFORMANCE AS A BASIS FOR SUIT ON THE CONTRACT

A. Substantial performance generally: Where one party *substantially performs* (i.e., does not materially breach), the other is not relieved of his duties. If the latter refuses to perform, the substantially performing party has an action for breach of contract. [343]

1. Expectation damages: Putting it more simply, *a party who substantially performs may sue for ordinary (expectation) damages for breach of contract, if the other party fails to perform*. The other party has a set-off or counterclaim for the damages he has suffered from the plaintiff's failure to completely perform. [343]

Example: Contractor contracts to paint Owner's house for \$10,000, with performance to be complete by April 1. There is no "time of the essence" clause, and no reason to believe that April 1 completion is especially important. Contractor finishes work on April 3. Owner refuses to pay. Contractor will be able to bring suit on the contract, and to recover expectation damages (the profit he would have made). Owner is not entitled to refuse to pay, and must simply be content with a counterclaim for damages (probably nominal ones) due to the late completion.

B. Divisible contracts: If the contract is *divisible* into separate pairs of "agreed equivalents," a party who has substantially performed *one of the parts* may recover on the contract for that part. That's true even though he has materially breached with respect to the other portions. [345]

VIII. SUITS IN QUASI-CONTRACT

A. Where allowed: There are a number of situations where recovery "on the contract" is not possible or allowed: (1) situations where there was no attempt even to form a contract, but the plaintiff deserves some measure of recovery anyway; (2) cases where there was an attempt to form a contract, but the contract is unenforceable because of Statute of Frauds, impossibility, illegality, etc.; (3) cases where there is an enforceable contract, but the plaintiff has materially breached, and therefore may not recover on the contract; and (4) cases where the defendant has breached but the plaintiff is not entitled to damages on the contract. In all of these situations, the plaintiff will often be allowed to recover in "*quasi-contract*." [345]

1. Measure of damages: Courts almost never award expectation damages in quasi-contract suits. Both reliance damages and restitution damages are frequently awarded in quasi-contract suits (with courts deciding which of these two to use based on the equities of the particular case.). [345]

B. No contract attempted: The courts sometimes award P a recovery where *no contract was even attempted*. The most common example is where P supplies *emergency services* to D, without first forming a contract to do so. (*Example:* P, a doctor, sees D lying unconscious in the street, and gives D CPR. The court will probably allow P to recover the fair market value of her services, in an action in quasi-contract.) [345]

C. Unenforceable contracts: The parties may attempt to form a binding contract which turns out to be *unenforceable* or avoidable. This may happen because of the Statute of Frauds, mistake, illegality, impossibility, or frustration of purpose. In any of these cases, the court will usually let P sue in quasi-contract, and recover either the value of the services performed (restitution) or P's reasonable expenditures (reliance). [346]

D. Breaching plaintiff: A plaintiff who has *materially breached* may normally bring a quasi-contract suit, and recover his *restitution interest*, less the defendant's damages for the breach. This is sometimes called a recovery in "*quantum meruit*" ("as much as he deserves"). [347]

Example: P agrees to work for D for one year, payment of the \$20,000 salary to be made at the end. P works for six months, then unjustifiably quits. P cannot recover "on the contract," because he has not substantially performed. But he will probably be allowed to recover in quasi-contract, for the fair value of the benefits he has conferred on D. The court will estimate these benefits (which will probably be one-half of the \$20,000 annual salary), and will subtract the damage to D of P's not performing the second six months.

1. Construction cases: Quasi-contract recovery by a breaching plaintiff is most often found in *construction* cases. Here, the builder gets to recover

the value to the owner of the work done, even where the work does not constitute substantial performance of the contract. [347]

2. Limited to pro-rata contract price: When a defaulting plaintiff sues in quasi-contract for his restitution interest, recovery is almost always limited to the *pro-rata contract price*, less the defendant's damages for breach. [348]

3. Willful default: In many states, a defaulting plaintiff may not recover in quasi-contract if his breach is "*willful*." [349]

Example: Contractor agrees to build a house for Owner for \$100,000. The contract expressly provides that all walls will be insulated with non-asbestos-based insulation. Contractor instead knowingly installs asbestos-based insulation, in order to save \$2,000 in material costs. Even though the resulting house has substantial value, many courts will not permit Contractor to recover anything at all, on the grounds that his breach was not only material but "willful," i.e., intentional and done for Contractor's financial advantage.

4. UCC gives partial restitution to breaching buyer: The UCC gives a *breaching buyer* a right to partial restitution with respect to any *deposit* made to the seller before the buyer breached. Under § 2-718(2), the seller can only keep *20% of the total contract price* or *\$500*, whichever amount is smaller – the balance must be refunded to the breaching buyer. [350]

IX. FORESEEABILITY

A. General rule: The "rule of *Hadley v. Baxendale*" limits the damages which courts will award for breach of contract. The "rule" says that courts will not award consequential damages for breach unless the damages fall into one of two classes: [352 - 353]

1. Arise naturally: The damages were *foreseeable* by any reasonable person, regardless of whether the defendant actually foresaw them; or

2. Remote or unusual consequences: The damages were *remote or unusual*, but only if the defendant had *actual notice* of the possibility of these consequences.

Example: P operates a mill, which has suspended operations because of a broken shaft. He brings the shaft to D, a carrier, to have it brought to another city for repairs. D knows that the item to be carried is a shaft of P's mill, but does not know that the mill is closed because of the broken shaft. D negligently delays delivery, causing the mill to stay closed for extra days. P sues for the profits lost during these extra days.

Held, P cannot recover for these lost profits. The lost profits were not foreseeable to a reasonable person in D's position, nor was D on notice of the special fact that the mill was closed due to the broken shaft. [*Hadley v. Baxendale*]

B. Parties may allocate risks themselves: The rule of *Hadley* may always be *modified* by express agreement of the parties. For instance, if P puts D on notice of the special facts, this may cause damages to be awardable which would not otherwise be. Alternatively, the parties can simply agree that even unforeseen consequential damages shall be compensable. [353]

X. AVOIDABLE DAMAGES

A. General rule: Where P *might have avoided* a particular item of damage by reasonable effort, he *may not recover* for that item if he fails to make such an effort. This is sometimes called the "*duty to mitigate*" rule. (But it's a "duty" only in the sense that if P fails to do it, he'll lose the right to collect damages, not in the sense that P has breached some obligation.) [356]

Example: P agrees to work as an employee of D for a two-year period, at an annual salary of \$50,000. After two weeks on the job, P is wrongfully fired. P must make reasonable efforts to get another job. If he does not, the court will subtract from his recovery the amount which it believes P could have earned at an alternative job with reasonable effort. Thus if the court believes that P could have lined up a \$40,000-a-year job, P will only be allowed to recover at the rate of \$10,000 per year for the remainder of the contract.

1. Reasonableness: The "duty to mitigate" only requires the plaintiff to make *reasonable efforts* to mitigate damages. For instance, P does not have to incur substantial expense or inconvenience, damage his reputation, or break any other contracts, in order to mitigate. [356 - 357]

B. Sales contracts: Here's what the UCC says about an aggrieved buyer or seller's obligation to mitigate: [357 - 358]

1. Buyer: If the seller either fails to deliver, or delivers defective goods which the buyer rejects, the *buyer* must "*cover*" for the goods if he can reasonably do so – he may not recover for those damages (e.g., lost profits) which could have been prevented had he covered. See [UCC § 2-715\(2\)\(a\)](#) (defining "consequential damages" to include only those losses "which could not reasonably be prevented by cover or otherwise..."). (If buyer does not cover when he could have done so, he will still be entitled to the difference between the market price at the time of the breach and the contract price, but he'll lose the ability to collect consequential damages that he might otherwise have gotten.) [357 - 358]

2. Seller: The *seller* has much less of a duty to mitigate, when it is the buyer who breaches by wrongfully rejecting the goods or repudiating before delivery. The seller can choose between reselling the goods (and collecting the difference between resale price and contract price), or not reselling them (and recovering the difference between market price and unpaid contract price); seller may also be able to recover lost profits. [358]

3. Summary: So in UCC cases, it is really only the buyer who has a practical duty to mitigate.

C. Losses incurred in avoiding damages: If the aggrieved party tries to mitigate his damages, and incurs *losses* or *expenses* in doing so, he may recover damages for these losses or expenses. As long as plaintiff acted *reasonably* in trying to mitigate, it does not matter whether his attempt was successful. [360]

XI. NOMINAL AND PUNITIVE DAMAGES

A. Nominal damages: Where a right of action for breach exists, but no harm has been done or is provable, P may get a judgment for *nominal damages*. That is, he may recover a small sum that is fixed without regard to the amount of harm he has suffered. [363]

B. Punitive damages: Punitive damages are rarely awarded in breach of contract cases. [363]

1. Tort: But if the breach of contract also *constitutes a tort*, punitive damages *are* recoverable. (*Example:* D, a car dealer, sets back the odometer on a used car before selling it to P. D then falsely claims that the car is "new." P will probably be able to recover punitive damages, because seller's act, although it was part of a contract, also constitutes the independent tort of fraud.) [363 - 364]

a. Bad faith as tort: Many courts now regard a party's *bad faith* conduct in connection with a contract as *being* itself a tort, for which punitive damages may be awarded. For instance, if a party breaches voluntarily, in order to make a better deal elsewhere, the court may find that this conduct constitutes bad faith punishable by punitive damages. [363]

i. Insurance company refusal to settle: If an *insurance company* refuses in bad faith to *settle a claim* that is covered by a policy it wrote, courts are quite likely to hold that the insured has suffered a tort, and can recover punitive damages against the insurer.

XII. LIQUIDATED DAMAGES

A. Definition: A "*liquidated damages clause*" is a provision, placed in the contract itself, specifying the *consequences of breach*. (Example: Contractor contracts to paint Owner's house for \$10,000. In the basic contract, the parties agree that for every day after the deadline that Contractor finishes, the price charged by him will be reduced by \$100. This provision is a liquidated damages clause.) [364]

B. General rule: Courts will enforce liquidated damages provisions, but only if the court is satisfied that the provision is not a "*penalty*." That is, the court wants to be satisfied that the clause really is an attempt to estimate actual damages, rather than to penalize the party for breach by awarding "damages" that are far in excess of the ones actually suffered. Therefore, in order to be enforceable, the liquidated damage clause must always meet one, and sometimes two, requirements: [365]

1. Reasonable forecast: The amount fixed must be *reasonable* relative to the anticipated or actual loss for breach; and

2. Difficult calculation: In some courts, the harm caused by the breach must be *uncertain or very difficult to calculate accurately*, even after the fact.

C. Reasonableness of amount: All courts refuse to enforce liquidated damages clauses that do not provide for a "*reasonable*" amount. [365 - 367]

1. Modern view: Courts disagree about the *time* as of which the amount must appear to be reasonable. Most courts today will enforce the clause if *either*: (1) the clause is a reasonable forecast when viewed *as of the time of contracting*; or (2) the clause is reasonable in light of the *actual* damages which have occurred. [365]

a. Unexpectedly high damages: This means that a clause which is an unreasonable forecast (viewed as of the time of contracting) can still be saved if it turns out that P's damages are unexpectedly high, and therefore in line with the clause.

2. No loss at all: Courts are split about whether to enforce a liquidated damages clause where P has sustained *no actual losses at all*. The Restatement does *not* enforce the clause if it turns out that no actual damage has been sustained. [366]

3. Blunderbuss clause: A "*blunderbuss*" clause stipulates the same sum of money as liquidated damages for breach of *any* covenant, whether trivial or important. Where the actual damage turns out to be *trivial*, most courts will not enforce a blunderbuss clause (or will interpret the clause as not applying to trivial breaches). [367]

a. Major loss: But if the breach turns out to be a *major* one (so that the liquidated amount is reasonable in light of the actual loss), courts are split on whether the blunderbuss should be enforced. The modern view is to *enforce* the blunderbuss where the actual loss is roughly equal to the damages provided in the clause.

D. UCC rules: The UCC basically follows the common-law rule on when a liquidated damages clause should be awarded. The UCC follows the modern view, by which the party seeking enforcement of the clause will succeed if the sum is reasonable viewed *either* as of the time the contract is made or viewed in light of the actual breach and actual damages. See [UCC § 2-718\(1\)](#) (clause enforceable if "reasonable in the light of the anticipated or actual harm caused by the breach..."). [368]

XIII. DAMAGES IN SALES CONTRACTS

A. Where goods not accepted: If the buyer has *not accepted* the goods (either because they weren't delivered, or were delivered defective, or because the buyer repudiated), the UCC gives well-defined rights to the injured party: [371 - 375]

1. Buyer's rights: If the seller fails to deliver at all, or delivers defective goods which the buyer rightfully rejects, the buyer has a choice of remedies. [371]

a. Cover: The most important is her right to "*cover*," i.e., to buy the goods from another seller, and to recover the *difference between the contract price and the cover price* from the seller. [§ 2-712\(2\)](#). The buyer's purchase of substitute goods must be "*reasonable*," and must be made "in good faith and *without unreasonable delay*." [§ 2-712\(1\)](#). [373]

b. Contract/market differential: If the buyer does *not* cover (either because she can't, or decides she doesn't want to), she can instead recover the *contract/market differential*, i.e., the difference between the contract price and the market price "at the time when the buyer learned of the breach...." [§ 2-713\(1\)](#). [373 - 374]

i. Time of breach: Typically, the buyer "learns of the breach" (setting the time for measuring the market price) at the time the breach in fact occurs (either through non-delivery or through receipt of defective goods). But if the breach takes the form of a *repudiation* in advance of the time for performance, most courts hold that the market price is to be measured as of the time the buyer learns of the repudiation. (See prior discussion.)

ii. Probably not available to covering buyer: Probably the buyer may recover the contract/market differential *only where she did not cover*. This means that if the market price declines between the time the buyer learns of the breach and the time he covers by buying substitute goods, the buyer can't get a windfall – limiting him to the contract/market differential puts him in the same position he would have been in had the contract been fulfilled, not a better one.

c. Consequential and incidental damages: The buyer, regardless of whether he covers, may recover for "*incidental*" and "*consequential*" damages. [374]

i. Consequential: *Consequential* damages include the *profits* which the buyer could have made by reselling the contracted-for goods had they been delivered. But remember that these profits must be proved with appropriate certainty, and must be shown to have been reasonably foreseeable at the time of the contract. [374]

ii. Incidental damages: "*Incidental*" damages include such items as transportation expenses, storage expenses, and other small but direct expenses associated with the breach and buyer's attempts to cover for it. [374]

d. Rejection: All of the above are judicial remedies. But the buyer who receives non-conforming goods can also exercise the self-help remedy of *rejecting the goods*. The buyer thus throws the goods back on the seller and cancels the contract. (Observe that where the buyer has actually made a losing contract, rejection lets him escape his bad bargain.) [374 - 375]

2. Seller's damages for breach: Where it is the buyer who breaches, by wrongfully refusing to accept the goods (or by repudiating the contract before shipment is even made), the seller has several possible remedies: [375 - 382]

a. Contract/resale differential: Normally, the seller will *resell the goods* to a third party. Assuming that the resale is made in good faith and in a "commercially reasonable" manner, seller may recover the difference between the *resale price* and the *contract price*, together with incidental damages. [375]

b. Contract/market differential: If the seller does *not* resell the goods, he may recover from the breaching buyer the difference

between the *market price* at the time and place for delivery, and the *unpaid contract price*, together with incidental damages. § 2-708(1). (Probably a seller who has resold the goods may *not* use this contract/market differential, but must use the contract/resale differential.) [377]

c. Lost profits: The contract/resale differential (for a reselling seller) and the contract/market differential (for a non-reselling seller) may not make the seller whole. Where this is the case, § 2-708(2) lets the seller recover his *lost profits* instead of using either of these differentials. [378]

i. "Lost volume" seller: Most importantly, this means that the *"lost volume"* seller may recover the profit he has lost by reason of the breach. In the usual case of a seller who has resold the item, a "lost volume" seller is one who (1) had a big enough supply that he could have made both the contracted-for sale and the resale; (2) probably would have made the resale anyway as well as the original sale had there been no breach; and (3) would have made a profit on both sales. [378]

Example: Auto Dealer sells cars made by Smith Motors. Auto Dealer can get as much inventory from Smith as Auto Dealer can sell. Auto Dealer contracts to sell a particular 1999 Thunder Wagon to Consumer for \$10,000. Consumer repudiates just before delivery. Auto Dealer resells the car for the same \$10,000 price to X, a walk-in customer.

The traditional contract/resale differential (here, \$0) would not make Auto Dealer whole, since he could have sold cars to both consumer and X and made a profit on each. Therefore, Auto Dealer can recover from Consumer the profit he would have made had the contract with Consumer been fulfilled. Auto Dealer is on these facts a "lost volume" seller.

d. Action for contract price: In a few situations, the UCC allows the seller to sue for the *entire contract price*: [379]

i. Accepted goods: First, if the buyer has *"accepted"* the goods, the seller may sue for the entire contract price (though the buyer has a counterclaim for damages for non-conformity). (*Example:* Buyer orders 10 widgets at \$50 each from Seller. Seller ships the goods late, but Buyer

keeps the goods for 30 days without saying anything. Buyer will be held to have "accepted" the goods, and Seller can therefore sue for the entire contract price, \$500. But Buyer may counterclaim for the damages he has actually suffered due to the late delivery.) [380]

ii. Risk of loss: Second, if the *risk of loss* has passed to the buyer, and the goods are lost in transit, the seller may sue for the entire contract price. (*Example:* As per the contract, Seller ships goods "F.O.B. Seller's plant." The goods are destroyed while on the trucking company's truck. Seller can sue for the whole price; Buyer's remedy is against the trucker.) [380]

iii. Unresaleable goods: Lastly, if the seller has already *earmarked* particular goods as being ones to be supplied under the contract, and the buyer rejects them or repudiates before delivery, seller may recover the entire contract price if he is *unable to resell them* on some reasonable basis. Most commonly, this applies to *perishable* goods and *custom-made* goods. [380]

e. Incidental damages: A seller who pursues and achieves one of the four above remedies (resale, contract/market differential, lost profits, action for price) may *also* recover "*incidental damages.*" These include such items as transportation charges, storage charges, and other charges relating to the seller's attempt to deal with the goods after the buyer's breach. See § 2-710. [381]

f. Consequential damages: Nearly all courts hold that the seller may *not* recover "*consequential damages.*" This is a big difference from how buyers are treated. [381]

B. Accepted goods: If the buyer has *accepted* the goods (and has not rightfully revoked this acceptance), then the remedies given to buyer and seller are different: [382]

1. Seller's action for price: If the buyer has accepted the goods, the seller may recover the *full contract price*. (But if the goods are non-conforming, Buyer may counterclaim for breach of warranty.) [382]

2. Buyer's claim: If the buyer has accepted the goods, and they turn out to be defective, buyer's remedy is to sue for breach of contract. [382 - 383]

a. Breach of warranty: Most importantly, buyer may sue for *breach of warranty*. These may be either express warranties or

warranties implied by the UCC. The measure of damages for breach of warranty is "the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount." § 2-714(2). [382]

b. Non-warranty damages: Buyer may also be able to recover for non-warranty damages. For instance, damages resulting from seller's *delay* in shipping the goods, or his breach of an express promise to *repair* defective goods, may be recovered on top of or instead of breach-of-warranty damages. [383]

Chapter 11
CONTRACTS INVOLVING MORE THAN TWO PARTIES

I. ASSIGNMENT AND DELEGATION GENERALLY

A. Assignment distinguished from delegation: Be sure to distinguish *assignment* from *delegation*: [394]

1. **Assignment:** When a party to an existing contract transfers to a third person her *rights* under the contract, she has made an *assignment*.
2. **Delegation:** When an existing party appoints a third person to perform her *duties* under the contract, she has made a *delegation*.
3. **Combination:** Frequently, an existing party will both assign and delegate. That is, she will both transfer her rights to a third person, and appoint the latter to perform her duties. But don't presume that where there is an assignment, there is necessarily a delegation, or vice versa – there will often be just an assignment, or just a delegation.

II. ASSIGNMENT

A. Present transfer: An assignment is a *present* transfer of one's rights under a contract. Thus a *promise* to transfer one's rights in the future is not an assignment, even though it may be a contract. [394]

1. **No consideration:** Because an assignment is a present transfer, *no consideration is required* for it (just as no consideration is required for a present gift).

B. Terminology: An assignment is a *three-part* transaction. The "*assignor*" assigns to the "*assignee*" the performance due the assignor from the "*obligor*." (Example: Contractor contracts to paint Owner's house for \$10,000. Contractor then assigns to Bank Contractor's right to receive the \$10,000 when due. Contractor is the assignor, Bank is the assignee, and Owner is the obligor.)

C. UCC rules: The *UCC* applies to many assignments, even ones not involving contracts for the sale of goods. In general, if a party assigns his *right to receive payment* under a contract as security *financing*, *Article 9* of the UCC applies to the terms of the assignment. [395 - 396]

Example: Contractor contracts to paint Owner's house for \$10,000. Contractor assigns his right to receive payment to Bank, in return for a present payment of \$9,500. Even though there is no contract for the sale of goods, Article 9 of the UCC applies to this assignment, and governs such items as whether the

assignment must be in writing, the rights of Bank against Owner if Owner does not pay, etc.

D. Writing: At common law, an assignment of contract rights does *not have to be in writing*. However, many states have statutes requiring certain types of assignments to be in writing. [396]

1. Article 9: In particular, where a party assigns to a third person his *right to receive payment*, in a financing-type transaction covered by Article 9 of the UCC, the assignment is not enforceable against either the assignor or the obligor unless the assignor has signed a document called a "*security interest*." See § 9-203.

E. Gratuitous assignments: A "*gratuitous assignment*" is an assignment that is in the nature of a gift, i.e., one in which the assignor receives nothing of value in return. Gratuitous assignments are generally *enforceable*, just like ones given for value. [396]

1. Revocability: But gratuitous assignments, unlike ones given for value, are automatically *revoked* if the assignor: (1) dies; (2) makes a *subsequent assignment* of the same right to a different person; or (3) gives *notice* to either the assignee or the obligor that the assignment has been revoked. [396]

a. Becomes irrevocable: But a gratuitous assignment may become *irrevocable* in some circumstances: [396]

i. Delivery of symbolic document: This can happen if the contract right being assigned is evidenced by a *document* that commonly *symbolizes* the right, and that document is delivered to the assignee. (*Example:* Insured, who owns an insurance policy on his own life, delivers the policy to Friend, with the words, "I am assigning you this policy." At that moment, the assignment becomes irrevocable, even though it was gratuitous.)

ii. Writing: If the assignor puts the assignment *in writing*, most courts treat it as irrevocable if the writing is delivered to the assignee.

iii. Reliance: If the assignee *relies to his detriment* on the assignment, and the reliance is reasonably foreseeable by the assignor, the assignment is irrevocable.

iv. Obligor's performance: If the obligor gives the assignee the *payment* or performance, the assignment becomes irrevocable.

F. What rights may be assigned: All contract rights are assignable, unless they fall within a small number of exceptions, most of which are noted below: [397 - 399]

1. Materially alter the obligor's duty: If the obligor's duty would be *materially changed* by the assignment, the assignment will be disallowed. [397 - 398]

a. Personal services contract: This happens most commonly in certain *personal services* contracts. If there is a special relationship of *trust* or *confidence* between the parties, for instance, assignment will usually not be allowed. (*Example:* Star, a movie star, hires Secretary for a below-market wage, which Secretary agrees to take because she wants to work closely with Star. Star probably cannot assign the contract to Friend, thus requiring Secretary to work for Friend for the same wages, because the assignment would materially alter Secretary's duties.)

2. Materially vary the risk: Assignment will also not be allowed if it will materially *vary the risk* assumed by the obligor. This is most commonly true of *insurance* policies. [398]

3. Impairment of obligor's chance to obtain return performance: An assignment may not be made if it would materially impair the obligor's chances of obtaining *return performance*. [398]

Example: Contractor contracts to paint Owner's house for \$10,000, with half the payment to be made before the job starts. Contractor then assigns all of his payment rights to Friend, to discharge a prior bill. A court might reason that since Contractor now stands to get no money, the chance that Owner will pay \$5,000 and not receive performance is sufficiently great that the assignment should not be allowed.

G. Contract terms prohibiting assignment: Normally, if the contract itself contains a *clause prohibiting assignment*, the courts will *enforce* the clause. But there are a number of important exceptions. [399]

1. Restatement: Under the Restatement, an anti-assignment clause is generally enforceable, but subject to the following rules: [400 - 401]

a. Fully performed: Assignment is allowed if the assignor has already *fully performed*. (In other words, an assignor who has

already earned the *right to payment* by doing the contracted-for work may always assign the payment right.)

b. Total breach: The right to *sue for damages* for breach of contract may always be assigned.

c. Ban on assigning "the contract": If the anti-assignment clause states that "*the contract*" may not be assigned (as opposed to stating that "rights under the contract may not be assigned"), the contract will be interpreted to bar only *delegation*, not assignment.

d. Damages: An assignment made in violation of an anti-assignment clause does *not* render the assignment ineffective. All it does is to give the obligor a right to *damages* against the assignor for breach.

e. Rules of construction: In any event, these rules are merely *rules of construction*. If the parties clearly manifest a different intent, that intent will be honored.

2. UCC: Where a party assigns his *right to payment* as *security for a loan* (bringing the assignment within Article 9 of the UCC), an anti-assignment clause is automatically *invalid*. [401]

H. Assignee vs. obligor: As a general rule, the assignee "*stands in the shoes of his assignor*." That is, with a few exceptions, he takes *subject to all defenses, set-offs and counterclaims which the obligor could have asserted against the assignor*. This is the most important single rule to remember about assignment. [402 - 409]

Example: Contractor contracts to paint Owner's house for \$10,000. Contractor assigns his right to payment to Wife, to satisfy an alimony obligation. If Owner fails to make payment, Owner may raise against Wife any defense, counterclaim or set-off that Owner could have raised against Contractor. Thus if the work was not done in a merchantable manner, Owner may raise this defense against Wife just as he could have raised it against Contractor.

1. Effect if obligor gives performance to assignor: Once the obligor has received *notice* of the assignment (from either the assignor or assignee), *she cannot thereafter pay* (or otherwise give her performance to) *the assignor*. If she does, she won't be able to use the defense of payment against the assignee. But if the obligor pays the assignor or otherwise gives him the required performance *before* she has received notice of the assignment, she may use this as a defense against the assignee. [403]

2. Modification of contract: The right of the obligor and assignor to *modify* the original contract depends mainly on whether the modification takes place before the obligor has notice of the assignment: [404]

a. Before notice: *Before* the obligor has received notice of the assignment, he and the assignor are *completely free* to modify the contract. (See [UCC § 9-318\(2\)](#).) [404]

Example: Contractor contracts to paint Owner's house for \$10,000, does the work, then assigns his right to payment to Bank. Before Owner receives notice of the assignment, Owner and Contractor can together agree to modify the contract, and this will be binding on Bank. For instance, they may agree to reduce the contract price.

b. After notice of assignment: But *after* notice of assignment has been given to the obligor, he and the assignor may modify the contract *only if the assignor has not yet fully performed*. [404]

Example: Same facts as above example. Now, assume that Contractor has already finished painting the house, and that Bank has notified Owner of the assignment. At this juncture, any attempt by Owner and Contractor to lower the contract price will not be binding on Bank.

i. Assignee gets benefits under modified contract: Where modification *is* allowed, the assignee gets the benefit of whatever new rights are given to the assignor by the modification.

3. "Waiver of defenses" clause: Many contracts contain "*waiver of defenses*" clauses, by which one party agrees that if the other assigns the contract, the former will not raise against the assignee defenses which he could have raised against the assignor. Most commonly, the buyer of goods on credit agrees that the seller may assign the installment contract, and that the buyer will not assert against the assignee (usually a bank or finance company) defenses which the buyer might have against the seller. The enforceability of such "waiver of defenses" clauses depends mostly on whether the transaction is a consumer one. [404 - 406]

a. "Real" defenses: A waiver-of-defenses clause is *never* effective as to so-called "*real*" defenses. "Real" defenses include: (1) infancy, incapacity, or duress; (2) illegality of the original contract; and (3) misrepresentation that induced the buyer to sign the contract without knowledge of its essential terms ("fraud in the essence"). See [UCC § 9-206\(1\)](#). [405]

b. Consumer goods: Very importantly, waiver-of-defenses clauses in *consumer transactions* are basically *unenforceable*. This stems mainly from an FTC regulation. [405]

i. Commercial contracts: By contrast, the FTC regulation does *not* apply to *commercial* contracts. So a businessperson who, say, buys goods on installment may not raise defenses such as breach of the implied warranty of merchantability against the assignee, typically a financing institution. [406]

4. Counterclaims, set-offs, and recoupment by the obligor: Most states (and the UCC) follow these rules for determining when the obligor may assert a *counterclaim*, *set-off* or *recoupment* in a suit brought against him by the assignee: [406 - 408]

a. Claim relates to assigned contract: If the obligor's claim against the assignor is related to the *same contract* that has been assigned to the assignee, the obligor may use this claim whether it arose *prior to* or *subsequent* to the obligor's receipt of notice of the assignment. See [UCC § 9-318\(1\)](#). This is called a "recoupment." It may only be used to reduce the assignee's claim, *not to yield an affirmative recovery* for the obligor. [406]

Example: Contractor agrees to paint Owner's house for \$10,000. Contractor assigns to Bank on July 1, and Bank notifies Owner of the assignment on July 2. If Contractor has done the work in a slightly improper or late way (whether the defect occurred before or after the July 2 notice), Owner may assert this as a defense in any suit brought by Bank for the money, and Bank's recovery will be diminished by this amount. (But no affirmative recovery by Owner will be allowed even if the damages aggregate more than \$10,000).

b. Claim unrelated to assigned contract: If the obligor's claim against the assignor is *not related to the contract* which has been assigned, the obligor may assert this claim against the assignee *only if the claim accrued before the obligor received notice of the assignment*. This is called a "*set-off*." Like recoupment, a set-off may not yield affirmative recovery. [407]

c. Counterclaims: The obligor may obtain an *affirmative recovery* against the assignee only if the claim relates to a transaction *directly between the obligor and the assignee*. This is called a *counterclaim*. [408]

Example: Same facts as above two examples. Assume that Owner also has a claim against Bank for lending him money at a rate in violation of state usury laws. Assuming that the claim is allowed to be part of the same suit under state practice rules, this claim can not only wipe out any recovery by Bank as assignee of the Contractor-Owner contract, but also may yield an affirmative recovery for Owner. But no claim by Owner relating to the Owner-Contractor contract may yield an affirmative recovery, since only dealings directly between the obligor (Owner) and the assignee/plaintiff (Bank) may yield such a recovery.

I. Rights of successive assignees of the same claim: Where there are *two assignees* of the same claim, and assuming that both assignees gave value and the later one did not know about the first, here is the way most states treat their relative rights: [409 - 410]

1. Restatement rule: In transactions not governed by Article 9 of the UCC, the Restatement "*four horsemen*" rule is applied by most states. The subsequent assignee loses to the earlier assignee, unless the subsequent one did one of four things: (1) he received *payment* or other satisfaction of the obligation; (2) he obtained a *judgment* against the obligor; (3) he obtained a *new contract* from the obligor by novation; or (4) he *possessed a writing* of a type customarily accepted as a symbol or evidence of the right assigned (e.g., a bank book or insurance policy). [409]

2. UCC: In transactions governed by Article 9 of the UCC (most assignments of the right to receive money in return for financing), rights of successive assignees are governed by a *filing system*. In general, the assignee who *files first* has priority, regardless of whether he received his assignment first, and regardless of whether he gave notice of the assignment to the obligor first. [409]

J. Rights of assignee against assignor: If the obligor is *unable to perform*, or in some other way the assignee doesn't obtain the value he expected from the contract, the *assignee* may be able to recover *against the assignor*. [410]

1. Gratuitous assignments: If the assignment was a *gratuitous* one, the assignee probably will *not* be able to recover against his assignor. Exceptions exist where the assignor interferes with the assignee's ability to collect the performance, or where the assignor makes a subsequent assignment. But in the more common case where the obligor simply *fails to perform*, the assignee has no *claim* against the assignor under a gratuitous assignment. [410]

2. Assignments made for value: But it is quite different if the assignment was made *for value*. Every assignor for value is held to have made a series of *implied warranties* to the assignee. If these warranties turn out not to be accurate, the assignee may sue the assignor for damages. These warranties are: [410 - 411]

a. No impairment: That the assignor will do nothing which will *interfere* with the assignee's enforcement of the obligation. (*Example:* Assignor implicitly promises that he will not try to collect the obligation himself, and that he will not assign it to some third party.) [411]

b. Claim is valid and unencumbered: That the assigned claim is a *valid* one, not subject to any *limitations or defenses* other than those that have been disclosed. (*Example:* Contractor agrees to paint Owner's house for \$10,000. Contractor performs the work sloppily, giving Owner a partial defense. Contractor then assigns to Bank his right to be paid. Regardless of whether Contractor knows, at the time of assignment, that Owner has a defense, Contractor breaches his implied warranty to Bank if he does not disclose to Bank Owner's defense of non-performance.) [411]

c. Documents valid: That any documents which are delivered to the assignee that purport to evidence the right are *genuine*. [411]

d. No warranty of solvency or willingness to perform: But the assignor does *not* warrant that the obligor is *solvent*, or that he will be *willing or able to perform*. Thus if the obligor turns out to be unwilling or unable to perform, the assignee has *no recourse* against the assignor. (*Example:* Same facts as above example. If Contractor does the work properly, but Owner goes broke, or simply refuses to pay, Bank cannot sue Contractor.) [411]

i. Free to agree otherwise: But the assignor may explicitly *agree* to guarantee the obligor's performance, in which case the assignee can sue if the obligor fails to perform.

e. Sub-assignees not covered: Unless the assignor indicates otherwise, his warranties do not extend to any *sub-assignee*, i.e., one who receives the assignment from the assignee. [411]

f. Rules of construction: All of the above rules on warranties are generally *common-law*, rather than statutory. Most states treat them as *rules of construction*, which may be varied by showing that the parties intended a different result. [411]

III. DELEGATION OF DUTIES

A. Definition: Recall that "delegation" refers to *duties* under a contract, not to rights. If a party to a contract wishes to have another person perform his duties, he delegates them. [413]

B. Continued liability of delegator: When the performance of a duty is delegated, *the delegator remains liable*. [413]

Example: Owner contracts with Contractor for Contractor to paint Owner's house for \$10,000. Contractor delegates his duties to Painter. If Painter fails to perform in the manner required by the original Owner-Contractor contract, Owner may sue Contractor for breach, just as if Contractor had improperly performed the work herself.

1. Novation: But the obligee may expressly agree to accept the delegatee's performance in place of that of the delegator. If he does so, he has given what is called a *novation*.

C. Non-delegable duties: In general, a duty or performance is *delegable*, unless the obligee has a *substantial interest in having the delegator perform*. [413 - 416]

1. Particular skills: Contracts which call for the promisor's use of his *own particular skills* are normally *not* delegable. Thus contracts involving *artistic performances*, the *professional services* of a lawyer or doctor, etc., are not delegable. Similarly, contracts in which there are duties of *close personal supervision* may not be delegated. [413]

2. Construction and repair contracts: *Construction* contracts, and contracts for the repair of buildings or machinery, are normally delegable. [415]

3. Agreement of parties: The parties have complete freedom to determine whether duties may be delegated. This cuts both ways: they may agree that duties which would otherwise be delegable may not be delegated, or conversely that duties normally thought to be too personal may in fact be delegated. [415]

D. Delegatee's liability: [416]

1. Two forms: A delegation agreement between delegator and delegatee may be in one of two forms: (1) the delegator may simply give the delegatee the *option* to perform, with the delegatee making no promise that she will perform; or (2) the delegatee may *promise* that she will perform. [416]

a. Option: If the delegatee is given the *option* to perform, the delegatee is *not liable* to *either* the delegator or the obligee.

b. Promise: If the delegatee has promised to perform, the delegatee may or may not be liable to the *obligee*. That is, the obligee may or may not be a *third party beneficiary* of the delegatee's promise. This is normally a question of intent of the parties – if delegator and delegatee intend that the obligee get the benefit of the delegatee's promise, then the obligee may sue the delegatee.

Example: Contractor promises Owner that Contractor will paint Owner's house for \$10,000. Contractor gets too busy to perform, but wants to make sure that Owner is not inconvenienced by a bad or tardy performance. Contractor therefore delegates performance to Painter, under terms that permit Painter to keep the \$10,000 fee when earned. Painter expressly promises to perform the work. A court would probably hold that Owner was an intended third party beneficiary of Painter's promise, so that Owner may sue Painter (not just Contractor) if Painter fails to perform.

2. "Assumption": If a delegatee is held to have undertaken liability to the obligee as well as to the delegator, he is said to have *assumed* the delegator's liability. [416]

3. Assignment of "the contract": If a party purports to "assign the contract" to a third person, this language will normally be interpreted to constitute a *promise* by the assignee to perform, and the obligee will normally be interpreted to be an *intended beneficiary* of this promise. [416 - 418]

a. Exception for land sales: But an assignment of "the contract" made by a *vendee* under a *land contract* will *not* usually be found to follow this rule. That is, the assignee under a land sale contract usually does *not* incur liability to the original seller. [416 - 417]

b. UCC: The UCC, in § 2-210(4), follows the common-law rule: "An assignment of 'the contract' or of 'all my rights under the contract' ... is an assignment of rights and unless the languages or circumstances ... indicate the contrary, it is a *delegation of performance* of the duties of the assignor and its acceptance by the assignee constitutes a *promise by him* to perform those duties. This promise is enforceable by *either* the assignor or the other party to the original contract." [417]

i. Security: But if a general assignment is made for the purpose of giving *collateral* to the assignee in return for a *loan*, the lender will *not* normally be deemed to have undertaken to perform the assignor's duties. (*Example:* On fact of the above examples, if Contractor assigns "the contract" to Bank, in return for a loan of \$9,000, Bank has not promised to paint the house, and may not be sued by Owner if the house does not get painted.) [417]

IV. THIRD PARTY BENEFICIARIES

A. Introduction: A *third party beneficiary* is a person whom the promisee in a contract intends to benefit. [421]

Example: Contractor agrees to paint Owner's house for \$10,000. Contractor wants to pay off a debt he owes Creditor, so he provides that upon completion, payment should be made not to Contractor but to Creditor. Creditor is a third party beneficiary of the Owner-Contractor contract.

B. When beneficiary may sue: The most important question about third party beneficiaries is: When may the third party beneficiary sue the promisor on the contract? The modern rule, exemplified by the Second Restatement, is that "*intended*" beneficiaries may sue, but "*incidental*" beneficiaries may not sue. [423]

1. Intended beneficiaries may sue: "Intended beneficiaries" fall into two categories: [423]

a. Payment of money: First, a person is an intended beneficiary if the performance of the promise will satisfy an obligation of the promisee to *pay money* to the beneficiary. This is sometimes called a "*creditor beneficiary*." [423]

Example: Contractor agrees to paint Owner's house for \$10,000. The contract provides that payment should be made to Creditor, to satisfy a debt previously owed by Contractor to Creditor. Since Owner's fulfillment of his side of the contract will cause money to be paid to Creditor, Creditor is an intended beneficiary, of the "creditor beneficiary" variety.

b. Intended beneficiary: Second, a person will be an intended beneficiary if the circumstances indicate that the promisee *intends to give the beneficiary the benefit* of the promised performance. A person may fall into this class even if the purpose of the promisee is to give a gift to the beneficiary (in which case the beneficiary is sometimes called a "*donee* beneficiary"). But intent to make a gift

is not necessary – a beneficiary may fall into this "intended beneficiary" class even if the promisee's purpose is not to make a gift, but rather to fulfill some other business objective. [423]

Example: Tycoon contracts with Painter for Painter to paint a portrait of Magnate, a businessman friend of Tycoon, and to deliver the portrait to Magnate. Since Tycoon intends for Magnate to get the benefit of Painter's performance, Magnate is an intended beneficiary who may sue Painter for non-performance; this is true even though Tycoon's motive is to butter up Magnate so that Magnate will do business with Tycoon.

2. Incidental beneficiaries: A beneficiary who does not fall into the above two classes is called an "*incidental*" beneficiary. An incidental beneficiary may *not* sue the promisor. [423]

Example: Developer contracts with Contractor to have Contractor put up an expensive building on developer's land. Neighbor, who owns the adjoining parcel, would benefit enormously because her land would increase in value if the building were built. However, since the parties don't intend to benefit Neighbor, and aren't paying money to her, Neighbor is an incidental beneficiary, not an intended one. Therefore, Neighbor cannot sue Contractor if Contractor fails to perform as agreed.

3. Public contracts: When *government* makes a contract with a private company for the performance of a service, a *member of the public* who is injured by the contractor's non-performance generally may *not* sue. (*Example:* City contracts with Water Co. to supply water for fire hydrants. P's house burns down when Water Co. does not give adequate hydrant pressure. *Held,* P is not an intended beneficiary of the City-Water Co. contract, and therefore may not recover. [*H.R. Moch & Co. v. Rensselaer*]) [425]

a. Exceptions: But there are two exceptions – a member of the public may sue: (1) if the party contracting with the government has *explicitly promised* to undertake liability to members of the public for breach of the contract; or (2) if the government has a *duty of its own* to provide the service which it has contracted for. (*Example:* City contracts to have its street-repair duty picked up by Contractor. A member of the public who is injured when the street is improperly maintained may sue Contractor).

4. Mortgage assumptions: In a fact pattern involving one party taking over another's *mortgage payments*, distinguish between two situations: (1) the mortgagor sells the property "*subject to*" the mortgage, in which

case the purchaser does not promise to pay off the mortgage, though he bears the risk of losing the property if the mortgage payments are not made; and (2) the purchaser "*assumes*" the mortgage, in which case he makes himself personally liable for repayment (so that the mortgagee may not only foreclose but also obtain a deficiency judgment against the purchaser). These two scenarios have different third party beneficiary consequences: [426 - 427]

a. Assumption: If the purchaser has *assumed* the mortgage, the mortgagee (i.e., the lender) is a *creditor beneficiary* of the assumption agreement between seller and buyer. The mortgagee may therefore sue the purchaser to compel him to make the mortgage payments. If the purchaser then sells to a sub-purchaser who also assumes, the lender may sue either the purchaser or the sub-purchaser if payments are not made. [426]

b. Subject to: Where the mortgagor sells to a purchaser who takes "*subject to*" the mortgage, the mortgagee cannot sue that purchaser, since the purchaser has incurred no liability. But if this non-assuming purchaser sells to a sub-purchaser who *does* assume, courts are *split* on whether the mortgagee can recover personally against the assuming sub-purchaser. [427]

C. Discharge or modification by the original parties: The modern view is that the original parties' power to *modify* the contract *terminates* if the beneficiary, before he *receives notification* of the discharge or modification, does any of three things: (1) materially *changes his position* in justifiable *reliance* on the promise; (2) *brings suit* on it; or (3) *manifests assent* to it at the request of either of the original parties. [427]

1. Clause preventing modification: The original parties may themselves agree at the time of contracting that no subsequent modification may occur without the beneficiary's consent. Such a clause will be honored. [428]

D. Defenses against the beneficiary: The promisor-defendant may assert against the beneficiary *any defenses which he could have asserted had he been sued by the promisee*. For instance, the promisor-defendant may defend on the ground that the promisee never rendered the performance which he promised under the contract, i.e., that the promisee breached. [428]

Example: Contractor agrees to paint Owner's house for \$10,000, with payment to be made to Friend, in repayment of a debt owed by Contractor to Friend. If Owner does not make payment and Friend sues Owner as a third party beneficiary, Owner may defend on the grounds that Contractor did not perform the painting work as promised.

1. Set-offs not allowed: But this principle that the beneficiary "stands in the shoes" of the promisee is limited – only defenses *relating to the main contract* may be asserted by the promisor-defendant. The promisor-defendant may *not* assert against the beneficiary defenses or claims from *unrelated transactions* with the promisee. [429]

Example: Same facts as above example. Contractor performs the painting work correctly. However, Contractor also owes Owner \$2,000 in damages from work previously done incorrectly by Contractor for Owner on a different contract involving Owner's office. If Friend sues Owner for the \$10,000 fee, Owner may not reduce the payment by the \$2,000 owed on the office contract.

E. Other suits in beneficiary contracts:

1. Beneficiary v. promisee: When the beneficiary sues the promisor, the beneficiary does *not* waive his right to later sue the promisee. (*Example:* Same facts as above example. Friend sues Owner, but recovers only \$4,000 because Owner shows that Contractor did not perform the house-painting work correctly. Friend may now sue Contractor for the remaining \$4,000 due.) [429]

2. Promisee vs. promisor: Most courts allow the promisee to bring her own suit against the promisor for benefit of the third party beneficiary, if the promisor breaches. [429]

a. Creditor beneficiary: This is most important where the third party is a *creditor* beneficiary. Here, most courts let the promisee-debtor recover from the promisor the amount which the promisor promised that he would pay the creditor (at least where the promisee has already paid the debt to the creditor).

Chapter 12
IMPOSSIBILITY, IMPRACTICABILITY & FRUSTRATION

I. INTRODUCTION

A. Nature of the problem: The parties may be *discharged* from performing the contract if: (1) performance is *impossible*; (2) because of new events, the fundamental *purpose* of one of the parties has been *frustrated*; or (3) performance is not impossible but is much more *burdensome* than was originally expected ("*impracticable*"). If a party is "discharged" from performing for such a reason, he is *not liable* for breach of contract. [438]

B. Risk allocation: The doctrines of impossibility, impracticability and frustration apply only where the parties themselves *did not allocate the risk* of the events which have rendered performance impossible, impracticable or frustrated. Thus the parties are always free to agree explicitly that certain contingencies will or will not render the contract impossible, etc., and these understandings will be honored by the courts. [439]

1. Question to ask: Therefore, in evaluating a problem that seems to involve impossibility, frustration, etc., always ask, "Did the parties expressly allocate the risk?" If they did, this allocation controls regardless of the general doctrines discussed here.

II. IMPOSSIBILITY OF PERFORMANCE

A. Generally: If a court concludes that performance of the contract has been rendered "*impossible*" by events occurring after the contract was performed, the court will generally *discharge* both parties. [440]

Example: Contractor agrees to paint Owner's house for \$10,000. Just before painting starts, the house burns down. A court will almost certainly conclude that performance has become impossible, and will therefore discharge both parties. Contractor does not have to do the painting, and Owner does not have to pay anything.

B. Three classes: There are three main types of impossibility: (1) destruction of the subject matter; (2) failure of the agreed-upon means of performance; and (3) death or incapacity of a party. [440]

1. Destruction of subject matter: If performance involves particular goods, a particular building, or some other tangible item, which through the fault of neither party is *destroyed* or otherwise made unavailable, the contract is discharged. The discharge will occur only where the particular subject matter is *essential* to the performance of the contract. [440 - 445]

a. Specifically referred to: If property which the performing party expected to use is destroyed, that party is discharged only if the destroyed property was *specifically referred to* in the contract, or at least understood by *both* parties to be the property that would be used. It is not enough that the party who seeks discharge intended to use the destroyed property. [441]

Example: Contractor agrees to paint Owner's house for \$10,000. Unknown to Owner, Contractor intends to use 100 gallons of paint which Contractor has left over from another job. After the signing, this paint is destroyed in a fire. Contractor will not be discharged by impossibility, because the specific left-over paint is not referred to in the contract, and is not understood by both parties to be the particular paint to be used in the contract.

b. Construction contracts: If a building contractor contracts to *construct* a building from scratch on particular land, and the building is destroyed by fire when it is partially completed, most courts hold that the contractor may *not* use the defense of impossibility. [442]

c. Repair of buildings: But when a party contracts to *repair* an *existing* building, she usually *will* be discharged if the building is destroyed. [443]

d. Sale of goods: Contracts for the sale of goods may or may not be discharged when there is destruction of the "subject matter" of the contract. [443 - 445]

i. General rule: The general UCC section applicable here is § 2-615(a), which provides that unless otherwise agreed, "delay in delivery or non-delivery ... is not a breach of [seller's] duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a *basic assumption on which the contract was made*...." [443]

ii. Destruction of identified goods: If a contract calls for the delivery of a particular *identified* unique good, and that good is destroyed before the "risk of loss" has passed to the buyer, the contract will be discharged. (*Example: A* contracts to sell to *B* a painting hanging on *A*'s wall. If the painting is destroyed before the delivery process starts, this will normally be before "risk of loss" has passed to *B*, and both parties will be discharged.) [444]

iii. Goods not identified at time of contracting: Usually, sale contracts call for goods to be taken from the seller's *general inventory*, not for particular identified goods. Where such unidentified goods are to be *shipped* by seller, and are destroyed *in transit*, the result depends on whether the contract is a "shipment" contract or a "destination" contract. In a "shipment" contract, where the seller's only obligation is to deliver the goods to the carrier (the contract usually says, "F.O.B. seller's plant" in this case), the *risk of loss passes to the buyer as soon as the seller delivers the goods to the carrier*; if the carrier loses the goods, the buyer bears the loss and must pay the purchase price, and sue the carrier. But if the contract is a "*destination*" contract ("F.O.B. buyer's place of business"), the risk of loss does not pass to the buyer until the carrier actually delivers; here, the seller cannot use the impossibility defense if the goods are destroyed while in transit. [445]

2. Impossibility of intangible but essential mode of performance: If an *essential* but *intangible* aspect of the contract becomes impossible, the contract may be discharged, just as where the "subject matter" is destroyed. [445 - 448]

Example: Seller contracts to deliver 100 widgets to Buyer at a stated price; both parties understand that Seller will get the widgets from Widget Co., with whom Seller has a long-term supply contract. If Widget Co. breaches or goes bankrupt, a court might hold that an essential intangible aspect of Seller's ability to perform has been nullified, and might let Seller use the impossibility defense.

a. Impossibility due to failure of third persons: Where a *middleman* contracts to supply goods that he will be procuring from some third party, and the third party cannot or will not supply the goods to the middleman, the middleman's ability to use the impossibility defense depends on the precise situation: [446 - 448]

i. Source not specified in contract: If the contract does *not specify* the source from which the seller is to obtain the goods, then the seller whose source does not pan out will almost surely *not* be allowed to use the impossibility defense. [446]

ii. Seller unable to make contract: Similarly, if the seller-buyer contract contemplates that the seller will procure the goods from a given supplier, and that supplier is *unwilling*

to contract to sell the items to the seller, the seller generally may *not* use impossibility. [446]

iii. Where seller's supply contract is breached: But if the contract contemplates that seller will make a particular supply contract, and seller does make a contract with this supplier, many courts will allow the impossibility defense if the *supplier breaches*. [447]

iv. Supplier excused by impossibility: Similarly, if the seller makes a contract with his supplier, and the *supplier is excused* by virtue of his own impossibility, the seller will probably also be discharged. [447]

3. Non-essential mode of performance: If *non-essential* aspects of the contract – such as ones dealing with the *means of delivery* or the means of payment – become impossible, usually the contract will *not* be discharged. Instead, a *commercially reasonable substitute* must be used. (*Example:* If *A* agrees to ship goods by post office to *B*, and the post office goes on strike, *A* must use a truck, UPS, or other commercially reasonable substitute.)

4. Death or illness: If a contract specifically provides that performance shall be made by a *particular person*, that person's *death or incapacity* will discharge both parties. [448]

a. Death or illness of a third party: A contract may similarly be discharged by virtue of the death or illness of some *third person*, who is necessary to performance of the contract even though he is not himself a party to it. (*Example:* Impresario contracts with Arena Co. to have Singer appear in a concert at Arena Co. If Singer develops laryngitis the day of the concert, the Arena-Impresario contract will be discharged by reason of impossibility, even though Singer is not directly a party.) [448]

b. Temporary impossibility: If events render performance of the contract only *temporarily* impossible, this will normally merely *suspend* the duty of performing until the impossibility ends. But if after the temporary impossibility is over, performance would be much more burdensome, then suspension will turn into discharge. [450]

III. IMPRACTICABILITY

A. Modern view of impracticability: Modern courts generally equate "*extreme impracticability*" with "impossibility." In other words, if due to changed

circumstances, performance would be *infeasible* from a commercial viewpoint, the promisor may be excused just as he would be if performance were literally impossible. [450 - 452]

1. UCC: The UCC deals with impracticability this way: § 2-615(a) provides that the seller's non-delivery is excuse "if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made...." Complete cutoffs of supplies (e.g., because of war, crop failure due to drought, strike, etc.) will often be found to be covered by 2-615, thus relieving the seller. [452]

2. Cost increases: Most impracticability cases relate to *extreme cost increases* suffered by sellers who have signed *fixed-price contracts*. Here, while it is theoretically possible for the seller of goods or services to escape the contracts on the grounds of impracticability, sellers generally *lose*. The reason is that such sellers are generally found to have implicitly *assumed the risk* of cost increases, when they signed a fixed-price contract. This is true both in services contracts and in sales contracts governed by the UCC. It is especially likely that the seller will lose where the cost increase was *foreseeable*. [452]

Example: Oil Co. contracts to sell to Utility oil for 10 years at a price of \$10 per barrel. Due to increased price discipline by OPEC, Oil Co.'s cost per barrel jumps from \$9 to \$29. A court will probably hold that Oil Co. cannot escape the contract on grounds of impracticability, because: (1) Oil Co. implicitly assumed the risk of price increases by agreeing to a fixed-price contract; and (2) disturbances in the supply of oil, with consequent price increases, were reasonably foreseeable to Oil Co. at the time it signed.

IV. FRUSTRATION OF PURPOSE

A. Frustration generally: Where a party's *purpose* in entering into the contract is destroyed by supervening events, most courts will discharge him from performing. This is the doctrine of "*frustration of purpose*." [453]

1. Distinguish from impossibility: Be sure to distinguish frustration of purpose from impossibility. In frustration cases, the person seeking discharge is not claiming that he "cannot" perform, in the sense of inability. Rather, she is claiming that it makes no sense for her to perform, because what she will get in return does not have the value she expected at the time she entered into the contract.

Example: P rents his apartment to D for a two-day period, at a very high rate. As known to P, D's purpose is to view the coronation of the new

king. The coronation is cancelled because of the king's illness. *Held*, D is discharged from performing because his purpose in entering the contract has been frustrated. [*Krell v. Henry*]

B. Factors to be considered: The two main factors courts have looked to, in deciding whether to apply the doctrine of frustration, are: [454]

1. Foreseeability: The less *foreseeable* the event which thwarts the promisor's purpose, the more likely the court is to allow the frustration defense. (*Example:* In *Krell*, it was quite unlikely, at the time of the contract, that the king would be too sick to be crowned.)

2. Totality: The more *totally* frustrated the party is, the more likely he is to be allowed to use the defense.

V. RESTITUTION AND RELIANCE WHERE THE PARTIES ARE DISCHARGED

A. Generally: Where the contract is discharged because of impossibility, impracticability or frustration, the courts generally try to adjust the equities of the situation by allowing either party to *recover the value* he has rendered to the other, and sometimes even the expenditures made in preparation. [459]

B. Restitution: Courts generally allow one who has been discharged by impossibility or frustration to recover in quasi-contract for *restitution*, i.e., for the value of the *benefit* conferred on the other party. [460]

1. Time for measuring benefit: Usually, the benefit is measured *just before the event* causing the discharge. (*Example:* Contractor contracts to paint Owner's house for \$10,000. After half the work is done, the house burns down. A court will first discharge both parties from the contract. It will then probably measure the benefit conferred by Contractor on Owner as of the moment just before the fire; if it concludes that \$5,000 "worth" of work had been done as of that moment, it will award this amount to Contractor.) [460]

2. Pro-rata contract price: Where the performance has been partly made, recovery will normally be limited to the *pro-rata contract price*, if such a pro-rating can be sensibly done. But if the reasonable value to the other party is *less* than the pro-rata contract price, this lesser value will be awarded. [460]

3. Down payment: If one party has made a *down payment* to the other prior to discharge, he will generally be allowed to recover this down payment. [459]

C. Reliance: Occasionally, if restitution will not "avoid injustice," the court will protect the parties' *reliance* interests instead. This might allow a party to recover his *expenditures* made in *preparation* for performance. [460]

1. Rare: Courts only *rarely* give reliance damages – if the performance does not actually render a benefit to the other party before discharge, the partly performing plaintiff is usually out of luck.

Chapter 13
MISCELLANEOUS DEFENSES

I. ILLEGALITY

A. Generally: In general, if a contract is found to be "*illegal*," the court will *refuse to enforce it*. [467]

B. Kinds of illegal contracts: Here are some of the kinds of contracts frequently found to be illegal and thus unenforceable: (1) "*gambling*" or "wagering" contracts; (2) lending contracts that violate *usury* statutes; (3) the pursuit of "maintenance" and "champerty," arrangements by which one person improperly finances another's lawsuit; and (4) the performance of services without a required *license* or *permit*. [467]

1. Non-compete covenants: A very important type of possibly illegal contract is a *covenant not to compete*. In general, if a non-compete agreement is *unreasonably broad*, it will be held to be illegal and not enforced. [468]

a. Sale of business: If the *seller of a business* is selling its "good will," his ancillary promise that he will not compete in the same business as the purchaser will be *upheld*, provided that it is not unreasonably broad either geographically or in duration. [468]

b. Employment contracts: *Employment agreements* often include a clause by which the employee agrees not to compete with his employer if he leaves the latter's employ. Such covenants are closely scrutinized by courts, and will be enforced only if they are designed to safeguard either the employer's *trade secrets* or his *customer list*. Even where these objectives are being pursued, the non-compete will be struck down if it is unreasonably broad as to geography or duration. [468]

i. Divisibility: If a non-compete is overly broad, most courts today will enforce it *up to reasonable limits*. Some courts apply the "*blue pencil*" rule, by which the clause will be enforced only if it can be narrowed by striking out certain portions (so that a ban on competing in "Ohio and Pennsylvania" could be modified by striking out "and Pennsylvania," but a ban lasting for "20 years" could not be modified by reducing it to "five years," since this would require redrafting, not merely striking). Most courts today, however, do not follow the blue pencil rule, and will

"redraft" the non-compete to bring it back to within reasonable limits. [469]

2. Cohabitation: Many courts refuse to enforce *cohabitation* agreements, i.e., agreements regarding property division entered into by couples who are living together without marriage. But a growing minority of courts now enforce such living-together arrangements, at least where they do not explicitly trade sex for money. [470 - 471]

C. Enforceability: As a general rule, *neither party to an illegal contract may enforce it*. This is not an ironclad rule. In general, contracts that are still *wholly executory* are less likely to be enforced by the court than those that have been at least partly performed. [471]

1. Wholly executory: If the contract is *completely executory* (i.e., neither party has rendered any performance), there are only a few situations where the court will allow one party to recover damages for breach: [471]

a. Ignorance of facts: Where one of the parties is justifiably *unaware* of the facts which make the contract illegal, and the other is not, the former may usually recover. (*Example:* Owner hires Electrician to perform electrical work; Owner does not know that Electrician is unlicensed. Owner may enforce the contract, even if he discovers the illegality before any work is done or payments made.) [471]

b. Wrongful purpose: Where only one party has a *wrongful purpose*, the other may recover for breach, at least if the wrongful purpose does not involve a crime of serious moral turpitude. (*Example:* *A* sells diamonds to *B* knowing that *B* plans to smuggle them into an Eastern Bloc country, where such importation is not allowed. *A* may recover for breach before money or goods changes hands, even if *A* knew of the proposed smuggling at the time of signing.) [471]

c. Statute directed at one party: If the statute is designed to *protect one party*, the person for whose protection the statute is designed may enforce the contract or sue for its breach. (*Example:* *A* agrees to sell stock to *B*, in violation of Blue Sky laws. *B*, as an investor whom the statute is designed to protect, may enforce the contract.) [472]

2. Partly- or fully-performed illegal contracts: Where one or both parties have *partly or fully performed*, the courts are more willing to enforce the contract or at least grant a quasi-contractual remedy. The three

above situations will generally lead to enforcement as in the wholly-executory situation. Also:

a. Malum prohibitum: If the conduct is illegal even though it does *not involve moral turpitude* (a contract involving "*malum prohibitum*" rather than "*malum in se*"), the court may allow the partly-performing party to recover at least the restitutionary value of his services. [472]

Example: Where a contractor fails to obtain a permit or license, and the permit or license is merely a revenue-raising rather than public-protection mechanism, the contractor may be able to recover the value of the work he has done.

b. Pari delicto: If one party, although blameworthy, is *much less guilty* than the other party, he may use the doctrine of "*pari delicto*" to gain enforcement. This may only be used where the plaintiff is not guilty of serious moral turpitude (but may be used even by a plaintiff who knew of the illegality). [472]

Example: If Bank lends money to Contractor for Contractor to build a house, even though Bank knows that Contractor is not licensed, there is a good chance that Bank will be held not to be "*in pari delicto*," and will thus be permitted to recover on the loan. But if Bank financed a cocaine deal, Bank's conduct would be found to be of serious moral turpitude, so the *pari delicto* doctrine would not apply, and Bank could not recover.

c. Divisibility: Finally, if a *divisible part* of the contract can be performed on both sides without violating public policy, the court will enforce that divisible portion. [473]

Example: Owner contracts to have Plumber supply a bathtub, and to install the bathtub. Plumber does not have a license. A court might hold that Plumber cannot recover that portion of the contract attributable to services, but might still allow Plumber to recover for the value of the tub he supplied.

II. DURESS

A. Generally: The defense of *duress* is available if D can show that he was *unfairly coerced* into entering into the contract, or into modifying it. Duress consists of "any wrongful act or threat which *overcomes the free will* of a party." [475]

1. Subjective standard: A *subjective standard* is used to determine whether the party's free will has been overcome. Thus even though the will of a person of "ordinary firmness" might not have been overcome, if D can show that he was unusually timid, and was in fact coerced, he may use the defense.

B. Ways of committing: Here are some of the acts or threats that may constitute duress: (1) *violence* or threats of it; (2) *imprisonment* or threats of it; (3) wrongful *taking* or *keeping* of a party's *property*, or threats to do so; and (4) threats to *breach* a contract or commit other wrongful acts. [475]

1. Abusive or oppressive acts: If one party *threatens another* with a certain act, it is *irrelevant* that the former would have had the *legal right* to perform that act – if the threat, or the ensuing bargain, are *abusive* or *oppressive*, the contract will be void for duress.

Example: Client hires Lawyer to prepare Client's defense against criminal charges, for a flat \$10,000 fee. The night before the trial is to begin, Lawyer tells Client, "Double the fee, or I'm resigning from the case." Client agrees. A court will probably hold that given the timing of Lawyer's threat, the threat and/or the ensuing bargain were abusive or oppressive, in which case the court will not enforce the modification.

C. Threat to breach contract: Most commonly, duress arises in contract cases because one party *threatens to breach the contract* unless it is *modified* in his favor; the other party reluctantly agrees, and the question is whether the modification is binding. In general, courts apply a "*good faith*" and "*fair dealing*" standard here: if the party seeking modification is using the other's vulnerability to extract an unfair advantage, the duress defense is likely to succeed. If, by contrast, the request for modification is due to unforeseen difficulties, the duress defense will probably fail. [476]

III. MISREPRESENTATION

A. Generally: If a party can show that the other made a *misrepresentation* to him prior to signing, he may be able to use this in either of two ways: (1) he may use this as a *defense* in a breach of contract action brought by the other; or (2) he may use it as the grounds for *rescission* or damages in a suit in which he is the plaintiff. [477]

B. Elements of proof: [477]

1. Other party's state of mind: P does *not* generally have to prove that the misrepresentation was *intentionally* made. A *negligent* or even *innocent* misrepresentation will usually be sufficient to avoid the contract, if it is made as to a *material fact*. [477]

2. Justifiable reliance: The party asserting misrepresentation must show that he *justifiably relied* on the misstatement. [477]

3. Fact, not opinion: The misrepresentation must be one of *fact*, rather than of *opinion*. (*Example:* A salesman's statement, "This is a very reliable little car," is probably so clearly opinion, or "puffing," that the buyer cannot rescind for misrepresentation by showing that the car in fact breaks down a lot. But, "This car gets 30 miles per gallon in city driving," is an assertion of fact, so it can serve as the basis for a misrepresentation claim.) [477]

C. Non-disclosure: As a general rule, only *affirmative statements* can serve as the basis for a misrepresentation action. A party's *failure to disclose* will generally *not* justify the other party in obtaining rescission or damages for misrepresentation. But there are some exceptions, situations where non-disclosure *will* support an action: [478]

1. Half truth: If *part of the truth* is told, but another part is not, so as to create an overall misleading impression, this may constitute misrepresentation. [478]

2. Positive concealment: If a party takes *positive action* to *conceal* the truth, this will be actionable even though it is not verbal. (*Example:* To conceal termite damage, Seller plasters over wooden beams in the house he is selling.) [478]

3. Failure to correct past statement: If the party knows that disclosure of a fact is needed to prevent some *previous assertion* from being misleading, and doesn't disclose it, this will be actionable. [478]

4. Fiduciary relationship: If the parties have some kind of *fiduciary relationship*, so that one believes that the other is looking out for her interests, there will be a duty to disclose material facts. [479]

5. Failure to correct mistake: If one party knows that the other is *making a mistake* as to a *basic assumption*, the former's failure to correct that misunderstanding will be actionable if the non-disclosure amounts to a "failure to act in *good faith*." (*Example:* Jeweler lets Consumer buy a stone, knowing that Consumer falsely believes that the stone is an emerald when it is in fact a topaz worth much less. This would probably be such bad faith that it would constitute misrepresentation.) [479]

IV. UNCONSCIONABILITY AND ADHESION CONTRACTS

A. Adhesion contracts: "*Adhesion contract*" is an imprecise term used to describe a document containing non-bargained clauses that are in fine print, complicated, and/or exceptionally favorable to the drafter. [481]

1. Refusal to enforce: If the court is convinced that: (1) the contract or the clause in question was *not negotiated*; and (2) the drafter had a *gross disparity in bargaining power*, the court may refuse to enforce the contract or clause. [481]

2. Tickets and other "pseudo contracts": Refusal to enforce what the court finds to be a "adhesion contract" is especially likely where the transaction is one in which the non-drafter does not even *realize that he is entering into a contract at all*. Parking-garage tickets, tickets for trains or planes, and tickets to sporting events, are examples: there is often contractual language in fine print on the back of the ticket, but the purchaser does not understand that by buying the ticket she is agreeing to the printed contractual terms. [483]

a. Refusal to enforce: The language printed on the ticket will generally be enforced only if: (1) the purchaser signs or somehow *manifests assent* to the terms of the ticket; and (2) the purchaser has *reason to believe* that such tickets are regularly used to contain contractual terms like those in fact on the ticket. Even if the ticket is found to be generally enforceable, the court will strike *unreasonable terms*.

B. Unconscionability: If a court finds that a contract or clause is so unfair as to be "*unconscionable*," the court may decline to enforce that contract or clause. See UCC § 2-302(1). [484]

1. No definition: There is no accepted definition of unconscionability. The issue is whether the clause is so *one-sided*, so unfair, that a court should as a matter of judicial policy refuse to enforce it. [484]

2. Consumers: Courts have very rarely allowed *businesspeople* to claim unconscionability; only *consumers* are generally successful with an unconscionability defense. [484]

3. Varieties: Clauses can be divided into two categories for unconscionability analysis: (1) "procedural" unconscionability; and (2) "substantive" unconscionability. [485]

a. Procedural: The "*procedural*" sort occurs where one party is induced to enter the contract without having any *meaningful choice*. Here are some possible types: (1) burdensome clauses tucked away in the fine-print boilerplate; (2) high-pressure

salespeople who mislead the uneducated consumer; and (3) industries with few players, all of whom offer the same unfair "adhesion contracts" to defeat bargaining (e.g., indoor parking lots in a downtown area, all disclaiming liability even for gross negligence). [485]

b. Substantive: The "*substantive*" sort of unconscionability occurs where the clause or contract itself (rather than the process used to arrive at the contract) is unduly unfair and one-sided. [485]

i. Excessive price: An important example of substantive unconscionability is where the seller charges an *excessive price*. Usually, an excessive price clause only comes about when there is also some sort of procedural unconscionability (e.g., an uneducated consumer who doesn't understand what he is agreeing to), since otherwise the consumer will usually simply find a cheaper supplier. [485 - 486]

ii. Remedy-meddling: Also, a term may be substantively unfair because it unfairly limits the buyer's *remedies* for breach by the seller. Types of remedy-meddling that might be found to be unconscionable in a particular case include: (1) disclaimer or limitation of *warranty*, especially prohibiting consequential damages for personal injury; (2) limiting the remedy to repair or replacement, where this would be a valueless remedy; (3) unfairly broad rights of *repossession* by the seller on credit; (4) waiver of defenses by the buyer as against the seller's *assignee*; and (5) a *cross-collateralization* clause by which a secured seller who has sold multiple items to a buyer on credit has the right to repossess all items until the last penny of total debt is paid. [486 - 488]

4. Remedies for unconscionability: Here are some of the things a court might do to remedy a clause or contract which it finds to be unconscionable: [488]

a. Refusal to enforce clause: Most likely, the court will simply *strike the offending clause*, but enforce the rest of the contract;

b. Reformation: Alternatively, the court may "*reform*" the offending clause (e.g., by modifying an excessive price to make it a reasonable price);

c. Refusal to enforce whole contract: Very occasionally, the court may simply refuse to enforce the *entire contract*, denying P any recovery at all.

V. CAPACITY

A. Generally: Certain classes of persons have only a limited power to contract. Most important are *infants* and the *mentally infirm*. For these people, any contract they enter into is *voidable* at their option – they can enforce the contract or escape from it. [488]

B. Infants: Until a person reaches majority, any contract which he enters into is *voidable* at his option. The age of majority is a matter of statute, and in most states is now 18. (*Example: A*, a 16 year old, agrees to sell Greenacre to *B*. *A* later changes his mind and refuses to go through with the sale. *B* may not enforce the agreement against *A*. But *A*, if he wishes, may enforce it against *B*, e.g., by suing *B* for damages for failure to go through with the purchase.) [488 - 491]

1. Disaffirmance: In nearly every state, an infant may avoid the contract even *before* he reaches majority. This is called "*disaffirmance*." He may do this orally, by his conduct (e.g., refusing to go through with the deal), or by a defense when sued for breach. [489]

a. Land conveyances: But where the contract is for a conveyance of *land*, most states do not allow the infant to disaffirm the contract until he has reached majority.

2. Ratification: A contract made by an infant is not void, but merely voidable, so the infant can choose to *enforce it* if he wishes. If he does this, he is said to have *ratified* the contract. [489 - 490]

a. Must reach adulthood: The most important thing to remember about ratification is that the minor *may not ratify until she has reached adulthood*. Ratification may occur in three ways:

i. Failure to disaffirm: By *inaction* – if the infant does not disaffirm within a reasonable time after reaching majority, she will be held to have implicitly ratified.

ii. Express: Expressly – the contract may be ratified by words, either written or (in most states) oral.

iii. By conduct: By *conduct* – if the former infant actively induces the other party to perform, this conduct may constitute a ratification (e.g., both parties begin to exchange performances after the infant's majority). But mere part

payment or part performance by the former infant is probably not by itself a ratification.

3. Economic adjustment: After disaffirmance, courts will try to make an economic adjustment to unwind the contract. [490 - 491]

a. Where infant is defendant: If the infant is a *defendant* to a breach-of-contract suit brought by the non-infant, the latter will not be allowed to recover profits he would have made, or any other contract damages. But he will have a limited right of *restitution*, the right to require the defendant infant to *return the goods* or other value *if he still has them*. [490]

b. Where infant is plaintiff: If the infant is a *plaintiff* who is suing to recover money already paid by him, the court will require the infant to return any value which he has, and will in fact subtract from the infant's recovery any value obtained and dissipated. (*Example:* Infant buys a car for \$4,000 in cash from D. Infant then disaffirms and sues to recover his \$4,000. To recover the \$4,000, Infant will have to return the car. If Infant has wrecked the car, or sold it for money which he has then spent, the value of the car will be subtracted from any recovery by Infant. So if the car was in fact worth \$4,000, Infant will recover nothing if he no longer has the car.) [490]

4. Lies about age: If the infant *lies about his age*, all courts let the other party *avoid the contract* on grounds of fraud. In other words, the infant who falsely claims adulthood loses his power to ratify the contract. [491]

C. Mental incompetents: A *mental incompetent* is governed by the same basic rules as an infant – he may either disaffirm the contract or ratify it. A person lacks capacity to contract because of mental incompetence if either: (1) he doesn't understand the contract; or (2) he understands it, but acts irrationally, and the other person knows he is acting irrationally. [491 - 493]

D. Intoxication: *Intoxication* will give a party the power of avoidance only if: (1) he is so intoxicated that he cannot *understand* the nature of his transaction; *and* (2) the other party has a *reason to know* that this is the case. [492]

Chapter 14 WARRANTIES

I. WARRANTIES GENERALLY

A. Types: Under the UCC, a seller may make several warranties that are of importance: (1) an *express* warranty; (2) an implied warranty of *merchantability*; and (3) a warranty of *fitness for a particular purpose*. If the seller breaches any of these warranties, the buyer may bring a damage action for breach of warranty, which can be viewed as a special type of breach-of-contract action. [498]

II. EXPRESS WARRANTIES

A. Definition: An express warranty is an *explicit* (not just implied) promise or guarantee by the seller that the goods will have certain qualities. See [UCC § 2-313\(1\)\(a\)](#): "Any *affirmation of fact or promise* made by the seller to the buyer which relates to the goods and becomes part of the *basis of the bargain* creates an express warranty that the goods shall conform to the affirmation or promise." [499]

1. Description: A *description* of goods can be an express warranty. (*Example:* A bill of sale issued by Jeweler to Consumer recites, "Three carat flawless white diamond ring." This constitutes an express warranty that the ring is a diamond with those characteristics.) [500]

2. Sample or model: If the buyer is shown a *sample* or *model*, this will normally amount to an express warranty that the rest of the goods conform to the sample or model. [500]

3. Puffing: If the seller is clearly "*puffing*," or expressing an *opinion*, he will not be held to have made a warranty. [500] (*Example:* A used-car salesperson's statement that, "This is a top-notch car," will probably be held to be mere puffing, not an express warranty of anything. But the statement, "This car will do 30 m.p.g. in city driving," is specific enough to amount to an express warranty.)

III. IMPLIED WARRANTY OF MERCHANTABILITY

A. Generally: The most important warranty given in the UCC is the implied warranty of *merchantability*. [UCC § 2-314\(1\)](#) provides: "Unless excluded or modified ... a warranty that goods shall be merchantable is *implied* in a contract for their sale if the seller is a *merchant* with respect to goods of that kind." [500]

B. Meaning of "merchantable": There is no precise definition of "merchantable." The most important meaning is that the goods must be "*fit for the ordinary purposes for which such goods are used.*" [§ 2-314\(2\)\(c\)](#). (*Example:*

Dealer sells a new car to Buyer. Due to a manufacturing defect, the car cannot go more than 25 m.p.h. Since cars are generally sold and used for high-speed highway driving, this would be a breach of the implied warranty of merchantability, even though Dealer never expressly promised any particular speed.) [501]

C. Always given unless disclaimed: The implied warranty of merchantability is *always* given by a merchant seller, unless it is expressly excluded by a *disclaimer* that meets stringent formal requirements imposed by the Code.

IV. WARRANTY OF FITNESS FOR PARTICULAR PURPOSE

A. Generally: Depending on the circumstances, a seller may be found to have impliedly warranted that the goods are *fit for a particular purpose*. UCC § 2-315 provides that "where the seller at the time of contracting has *reason to know* any particular purpose for which the goods are required and that the buyer is *relying on the seller's judgment* to select or furnish suitable goods, there is ... an implied warranty that the goods shall be fit for such purpose." [501]

B. Elements: The buyer must prove three things to recover for breach of this implied warranty: (1) that the seller had reason to know the buyer's *purpose*; (2) that the seller had reason to know that the buyer was *relying* on the seller's skill or judgment to furnish suitable goods; and (3) that the buyer *did in fact rely* on the seller's skill or judgment. [501]

1. Use of trade name: If the buyer insists on a particular *brand* of goods, he is not relying on the seller's skill or judgment, so no implied warranty of fitness for a particular purpose arises. [502]

V. PRIVACY

A. Definition: Two persons are "*in privity*" with each other if they contracted with each other. [502]

B. When privity is necessary: UCC § 2-318, stating when privity is necessary for a UCC breach-of-warranty action, actually has three separate alternatives. Each has been adopted in some states. [503]

1. Alternative A: Alternative A extends the seller's warranty (express or implied) only to a member of the buyer's *family* or *household*, or a house guest, and only where it is foreseeable that the person may use and be injured by the goods. A person other than the buyer thus cannot recover in states adopting Alternative A unless he is *physically injured*, and is a *relative or house guest* of the buyer. [503]

2. Alternative B: Alternative B covers any person, even if not a relative or house guest of the buyer, who may reasonably be expected to use or be affected by the goods. But, as with Alternative A, only *personal injury* is covered. [503]

3. Alternative C: Alternative C is the broadest: it extends the warranty to all persons who may be expected to use or be affected by the goods. Most importantly, it covers *property* and *economic* damage as well as personal injury, and may even cover intangible economic loss. [503]

VI. DISCLAIMERS OF WARRANTY

A. Generally: The UCC limits the extent to which a seller may *disclaim* warranties. [503 - 506]

B. Express warranties: The seller is basically free to disclaim *express* warranties, as long as he does so in a clear and reasonable way. However, this rarely happens – since nothing forces the seller to make an express warranty in the first place, he will usually have no reason to disclaim it after making it. [503]

C. Implied warranties: Disclaimers of the two *implied* warranties (merchantability and fitness for particular purpose) are tightly limited by the Code: [504 - 505]

1. Explicit disclaimers: The seller may make an *explicit disclaimer* of these warranties, but only by complying with strict procedural rules: [504]

a. Merchantability: A disclaimer of the warranty of *merchantability* must *mention the word "merchantability."* § 2-316(2). The disclaimer does not have to be in writing, but *if it is in writing, it must be "conspicuous."* In other words, the disclaimer cannot be buried in the *fine print* of the contract. (Usually, capital letters, bold face type, bigger type, or a different color type are used to meet the "conspicuous" requirement where the disclaimer is written.) [504]

b. Fitness for a particular purpose: A disclaimer of the warranty of fitness for a particular purpose *must be in writing*, and must also be *conspicuous*. (But it does not need to use any particular words, in contrast to a disclaimer of the warranty of merchantability.) (*Example:* The following language, if in writing and conspicuous, would suffice: "There are no warranties which extend beyond the description on the face hereof.") [504]

2. Implied limitations and disclaimers: There are also several ways in which the implied warranties may be *implicitly* limited or disclaimed: [505]

a. Language of sale: The *language of the sale* may implicitly disclaim the warranty. Most importantly, if the sale is made "*as is,*" this will implicitly exclude all implied warranties.

b. Examination of sample or model: If the buyer is asked to *examine* a *sample* or *model*, or the *goods themselves*, there is no implied warranty with regard to defects which an examination ought to have revealed. UCC § 2-316(3)(b). (*Example:* Buyer buys a floor sample T.V. from Dealer. If inspection of the cabinetry would have shown a dent, Buyer cannot claim that the dent is a violation of the implied warranty of merchantability.)

c. Course of dealing: An implied warranty can be excluded or modified by *course of dealing*, *course of performance*, and *usage of trade*. (*Example:* The dealings of the parties on prior contracts might create a "course of performance" to the effect that the goods are bought "as is" in return for a lower price.)

D. Magnuson-Moss: A federal law, the [Magnuson-Moss FTC Act](#), provides that where a written warranty is made to a *consumer*, the warrantor may not "disclaim or modify" any implied warranty. So if the maker or seller of a consumer good wants to give an express warranty in writing, he must also give the two implied warranties. [506]

VII. MODIFYING CONTRACT REMEDIES

A. UCC limits: Instead of disclaiming warranties, the seller may try to *limit* the buyer's *remedies* for breaches of warranty or other contract breaches. (*Example:* Seller may insert a clause that Buyer's remedies are limited to repair or replacement of defective goods or parts, with no consequential damages.) But the UCC limits the seller's right to do this "remedy meddling" in two ways. [506 - 507]

1. "Failure of essential purpose": First, if the remedy as limited by seller would "*fail of its essential purpose,*" the standard UCC remedies come back into the contract. [506]

Example: Seller sells yarn to Buyer, knowing that Buyer will dye the yarn and use it in products. Seller limits the warranty to repair or replacement of defective yarn. Buyer then spends a great deal of labor knitting the yarn into expensive sweaters, which fall apart due to poor quality yarn. A court might hold that here, repair or replacement of yarn that has already been

expensively knitted into sweaters would be a useless remedy, in which case the basic Code remedy of money damages for breach of the implied warranty of merchantability would re-enter the contract.

2. Unconscionability: Second, the court will refuse to enforce a damage limitation if it finds that this is *unconscionable*. According to § 2-713(3): (1) barring consequential damages for *personal injury* will virtually always be unconscionable; but (2) limiting damages where the loss is *commercial* will generally not be unconscionable. [507]

Chapter 15
DISCHARGE OF CONTRACTS

I. RESCISSION

A. Mutual rescission: As long as a contract is *executory* on both sides (i.e., neither party has fully performed), the parties may agree to *cancel* the whole contract. This is a "*mutual rescission*." [510]

1. No writing: In most states, a mutual rescission does *not have to be in writing*. This is true even if the original contract fell within the Statute of Frauds. [511]

2. Fully performed on one side: If the contract has been *fully performed* on one side, a mutual rescission will *not be effective*, because there is no mutual consideration. [511]

B. Unilateral rescission: Where one of the parties to a contract has been the victim of fraud, duress, mistake, or breach by the other party, he will generally be allowed to cancel the contract, terminating his obligations under it. Some courts call this a "*unilateral rescission*." But it is better to say that the innocent party may "*cancel*" or "terminate." [511]

II. ACCORD AND SATISFACTION

A. Executory accord generally: An *executory accord* is an agreement by the parties to a contract under which one promises to render a *substitute performance* in the future, and the other promises to *accept that substitute* in discharge of the existing duty. (*Example:* Debtor owes Creditor \$1,000 due in 30 days. Creditor promises Debtor that if Debtor will pay \$1,100 in 60 days, Creditor will accept this payment in discharge; Debtor promises to make the \$1,100 payment in 60 days. The new agreement is an executory accord.) [511]

B. Consequences: Executory accords are enforceable. However, an accord does *not discharge* the previous contractual duty as soon as the accord is made; instead, no discharge occurs until the terms of the accord are *performed*. Once the terms of the accord are performed, there is said to have been an "accord and satisfaction." [511 - 512]

1. Failure to perform accord: If a party *fails to perform* under the terms of the executory accord, the other party may sue for breach of the *original agreement*, or breach of the accord, at her option. (*Example:* On the facts of the above example, if Debtor fails to make the \$1,100 payment, Creditor may sue for either \$1,000 plus damages for failure to get the money in 30 days, or \$1,100 plus damages for failure to get the money in 60 days.) [512]

III. SUBSTITUTED AGREEMENT

A. Nature of substituted agreement: A "*substituted agreement*" is similar but not identical to an executory accord. Under a substituted agreement, the previous contract is *immediately discharged*, and replaced with a new agreement. (*Example:* On the facts of the above example, if the new agreement were found to be a substituted agreement rather than an executory accord, and Debtor then failed to make the payment in 60 days, Creditor would only be able to sue on the new promise, not the old promise.) [512 - 514]

1. Distinguishing: In determining whether a given agreement is a substitute agreement or executory accord, an important factor is whether the claim is a disputed one as to liability or amount – if the debtor in good faith *disputes* either the existence of the debt or its amount, the presumption is that there is a substituted agreement. If the amount and obligation are undisputed, the presumption will be that there is an executory accord. [513]

a. Level of formality: Another important factor in distinguishing substituted agreements from executory accords is the *level of formality*: the more *deliberate and formalized* the agreement, the more likely it is to be a substituted agreement. For instance, an *oral* agreement is very likely to be an *accord*, not a substituted agreement, because of its informality. [513]

B. Writing: If the substituted agreement would have to satisfy the Statute of Frauds were it an original contract, the substituted agreement must be in *writing*. (Some states also require the substituted agreement to be in writing if the original is in writing, even where neither falls within the Statute of Frauds.) [514]

IV. NOVATION

A. Definition: A "*novation*" occurs where the obligee under an original contract (the person to whom the duty is owed) agrees to relieve the obligor of all liability after the duty is *delegated* to some third party. A novation thus substitutes for the original obligor a stranger to the original contract, the delegatee. [514]

Example: Contractor agrees to paint Owner's house for \$10,000. Contractor does not have enough time to get the job done, so with Owner's consent he recruits Painter to do the job instead. If Owner agrees to release Contractor from liability, the result is a novation: Painter steps into the shoes of Contractor, and only Painter, not Contractor, owes a duty to Owner.

B. Consent: The obligee must *consent* to the novation. But the obligor, who is being discharged, need not consent. (*Example:* On the facts of the above example,

Owner must consent to the novation, but Contractor need not consent, at least to the delegation/release aspect of it.) [514]

V. ACCOUNT STATED

A. Generally: Where a party who has sold goods or services to another sends a *bill*, and the buyer holds the bill for an unreasonably long time *without objecting* to its contents, the seller will be able to use the bill as the basis for a suit on an *"account stated."* The invoice is not dispositive proof that that amount is owing, but the burden of proving that the invoice is wrong shifts to the buyer. [515]

VI. RELEASES

A. Generally: Where a contract is executory only on one side, the party who has fully performed may give up his rights by virtue of a *release*, a document executed by him discharging the other party. [515]

B. Formal requirements: In most states, a release must either be supported by *consideration*, or by a statutory substitute (e.g., a signed writing). [515]

1. UCC view: Under the UCC, a signed writing can release a claim for breach of contract, even without consideration.